

1 UNITED STATES BANKRUPTCY COURT

2 SOUTHERN DISTRICT OF NEW YORK

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4 In re:

5
6 LEHMAN BROTHERS HOLDINGS INC.,

7 Case No. 08-13555(SCC)

8 Debtors.

9 - - - - - x

10 LEHMAN BROTHERS HOLDINGS INC.,

11 as Plan Administrator,

12 Plaintiff,

13 v.

Adv. Case No. 13-01719(SCC)

14 WELLMONT HEALTH SYSTEMS, INC.,

15 Defendant.

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17 - - - - - x

18
19 U.S. Bankruptcy Court

20 One Bowling Green

21 New York, New York

22

23 February 11, 2015

24 10:09 AM

25

1 B E F O R E :

2 HON SHELLEY C. CHAPMAN

3 U.S. BANKRUPTCY JUDGE

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7 Hearing re: Doc. #46785 Four Hundred Eighty-Third Omnibus
8 Objection to Claims (No Liability claims)

9

10 Hearing re: Doc #47101 Four Hundred Eighty-Eighth Omnibus
11 Objection to Claims (No Liability Claims)

12

13 Hearing re: Adv. 13-01719 - Doc #20 Motion to Dismiss
14 Counts II, III & IV of Plaintiffs Complaint

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24 Transcribed by: Dawn South, Debra McCostlin, and Sheila
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1 P R O C E E D I N G S

2 THE COURT: How is everyone today?

3 (A chorus of good morning)

4 THE COURT: We had a rare break of sun yesterday,
5 so I had to shield the witness from the sun, but we're going
6 to open it up.

7 All right. Who would like to start?

8 MR. MILLER: Good morning, Your Honor.

9 THE COURT: Good morning, Mr. Miller.

10 MR. MILLER: May it please the Court, I'm Ralph
11 Miller from Weil, Gotshal & Manges here for the plan
12 administrator, Lehman Brothers Holdings Inc. or LBHI, and
13 the other Chapter 11 estates that are sued in this rather
14 broad claim or the claims against.

15 This agenda item deals with the four hundred
16 eighty-third omnibus objection to claims, and specifically
17 with the Stonehill claimants, which are Stonehill
18 Institutional Partners LP and Stonehill Offshore Partners
19 Limited.

20 Even if the Court treats all the facts as true
21 that are asserted in the Stonehill claims themselves,
22 together with all the facts that are asserted in the
23 Stonehill response to the four hundred and eight-third
24 objection, no claim is stated for relief.

25 The Stonehill claims all arise from prime

1 brokerage agreements that contain only performance
2 obligations of Lehman Brothers Inc., that is LBI.

3 As the objection and reply of the plan
4 administrator have shown, the central contract claim of
5 Stonehill cannot impose any liability on E debtors in this
6 Chapter 11 case for a number of reasons, and each of
7 Stonehill's creative efforts to plead a tort claim related
8 to that alleged breach of the prime brokerage contract has a
9 series of reasons why those tort claims also are
10 insufficient.

11 I'd like to start with the nature of the loss
12 asserted and then talk about the simplest reasons that both
13 the central contract claim and the add-on tort claims fail,
14 and then there are layers of reasons that these claims are
15 defective, and in the interest of brevity I will summarize
16 some of those, but I'd like to reserve some time if they are
17 raised in the response and talk about them specifically.

18 Let me talk about the claim and issue first, which
19 is important. We need to start by being clear about what
20 the claim is, and it's stated in paragraph 9 of the
21 attachment to each proof of claim. And the first sentence
22 reads in a way that contains three critical facts, and if I
23 might take a moment and put that in the record.

24 THE COURT: Uh-huh.

25 MR. MILLER: Paragraph 9 says:

1 "In addition the debtor and Lehman entities are
2 obligated to claimant for damages, interest, costs,
3 attorneys' fees, including, but not limited to, the amount
4 respecting the diminution in value of the securities held by
5 LBI under the PD agreement from the date in which LBI's SIPA
6 proceeding was commenced through the date that such
7 securities were returned to claimant."

8 This is the only place there's any specificity
9 that I can find about the mechanism that is said to have
10 caused the loss. There are some allegations that because
11 they didn't have these claims they had some foreign exchange
12 losses and they had some attorneys' fees and they had some
13 diminution of value, but the essence of the claim is that
14 during the period of time from the filing the SIPA
15 proceeding under the return of securities they didn't have
16 access to their securities.

17 THE COURT: So for shorthand we'll call this the
18 diminution claim?

19 MR. MILLER: That's fine, Your Honor, I think
20 that's fair. Again, I suppose a foreign exchange may not
21 technically be a diminution exactly, but --

22 THE COURT: Okay. Can I just ask you just a
23 threshold question, because there's a lot of aspects of
24 this, and I appreciate your trying to -- simplify is not the
25 right word -- but categorize, if you will. And maybe this

1 is a little bit of a softball for you, but here it comes.

2 How would this be different -- in your view the
3 claim that Stonehill is seeking to assert, the diminution
4 claim, how would it be different from the same claim that
5 every other customer of the prime brokerage firm had for
6 diminution of the securities?

7 Stated differently, if Stonehill has this claim
8 doesn't every customer of LBI have this claim if its
9 securities were diminished?

10 MR. MILLER: Well certainly, Your Honor, any
11 holder that had a portfolio of complex securities is going
12 to have some of these costs that they are asserting. I
13 suppose, Your Honor, to be completely candid it's possible
14 that if somebody had a -- had Apple stock and they were just
15 going to leave it sitting there and the Apple stock just
16 went up and up and up --

17 THE COURT: Sure. No, I'm assuming --

18 MR. MILLER: -- and they got it back --

19 THE COURT: -- I'm assuming diminution.

20 MR. MILLER: Yes.

21 THE COURT: I'm assuming diminution.

22 MR. MILLER: If there was a diminution and if
23 there were foreign exchange effects, if there was interest
24 cost, if there was something they could show that they did
25 because they didn't have access to their securities of

1 course. This is something everybody would have, and frankly
2 this would basically be a way around the SIPA proceeding to
3 all the affiliates of --

4 THE COURT: So -- right. So now you're getting to
5 the heart of my question, which I guess is more -- should be
6 more direct than at Mr. Brilliant.

7 So there aren't a spool of these asserted or let
8 alone allowed claims at the debtors other than LBI.

9 MR. MILLER: Well, I think that's true, Your
10 Honor, and you're going to hear one in a few minutes that is
11 -- that has some similarity --

12 THE COURT: Yes.

13 MR. MILLER: -- to this one, Your Honor, and there
14 have been some other prime brokerage claims, but I think
15 these are among the very few that are left, as I understand
16 it. Maybe Mr. Fail --

17 THE COURT: Mr. Fail?

18 MR. MILLER: -- can clarify the numbers.

19 MR. FAIL: Yes, Your Honor. These and the new
20 court ones are -- that you'll hear later today are the only
21 ones remaining against the Chapter 11 estates, none were
22 allowed against the Chapter 11 estates.

23 THE COURT: And were they simply not pursued or
24 where they stricken by Judge Peck after prior hearings on
25 these? Do you know, Mr. Fail?

1 MR. FAIL: The vast majority have been -- well, I
2 don't want to say that. There's a combination of
3 withdrawals -- voluntary withdrawals and court orders, but
4 none of a contested. So a number of objections were filed
5 and responses were not submitted.

6 THE COURT: Okay. But there was no disposition on
7 the merits of this issue in this case by Judge Peck.

8 MR. FAIL: There was no dispositions on the
9 merits.

10 THE COURT: Okay.

11 MR. FAIL: And one caveat, Your Honor, when I said
12 Chapter 11 estates I referred to -- I meant to refer to
13 other than LBHI there are certain claims outstanding related
14 to guaranteed claims, but --

15 THE COURT: Different.

16 MR. FAIL: -- those are contractual based on a
17 guarantee not --

18 THE COURT: Different. Right. Okay.

19 MR. FAIL: Thank you.

20 THE COURT: Okay. Thank you. Sorry for the
21 interruption, Mr. Miller. Go ahead.

22 MR. MILLER: And, Your Honor, I think that that is
23 important to bear that in mind.

24 I want to go back to the three key facts from what
25 they do asserting their claim.

1 First these are about securities held by LBI under
2 the plan agreement. They were held by LBI. There's no
3 allegation here that these securities were ever held by any
4 of the Chapter 11 debtors.

5 THE COURT: But there's a bailee -- there's a
6 bailment allegation.

7 MR. MILLER: There is a bailment, and I'll deal
8 with that --

9 THE COURT: Okay.

10 MR. MILLER: -- Your Honor. We take that as a
11 misreading of the contract, but it also can't be a bailment
12 if the party doesn't hold it. You have to hold the object
13 to be -- to at least have an implied bailment.

14 The second point is that the securities were
15 returned to claimant. They're not saying there was a
16 shortage of securities or the securities were lost or the
17 securities were sent to any of the Chapter 11 debtors and
18 mishandled, any of that.

19 And finally the duration of the claimed loss and
20 value is from the date in which LBI's SIPA proceeding was
21 concerned through the date the securities were returned. So
22 it precisely corresponds with the filing of the SIPA
23 proceeding and it goes through the date that they got them
24 back.

25 It's important what is not alleged, it is not

1 alleged that any of the affiliates ever held, handled, or
2 had the right to hold or handle any of these securities.
3 And it's not alleged that there were any damages before the
4 SIPA proceeding was commenced. It's not alleged that LBHI
5 or any of its affiliates ever received any benefit from
6 holding these securities over this period of time.

7 Now let me talk a little bit about the simplest
8 way to resolve these claims, which is the broad force
9 majeure clause in paragraph -- Section 29 of both
10 agreements.

11 As summarized in our papers and with some ellipses
12 it exculpates all the Chapter 11 estates from "any loss
13 caused directly or indirectly by government restrictions ...
14 suspension of trading ... or other conditions beyond Lehman
15 Brothers' control." This is virtually identical to the
16 clause and a similar clause considered by Judge Glenn in MF
17 Global. He properly found that clause was triggered by a
18 SIPA proceeding because the alleged damages as here flowed
19 directly or indirectly from government restriction or
20 suspension of trading.

21 Now there are some factual differences within
22 that --

23 THE COURT: Right. So that was -- the SIPA
24 proceeding was the debtor.

25 MR. MILLER: Yes, Your Honor.

1 THE COURT: But here the SIPA proceeding is the
2 affiliate.

3 MR. MILLER: The SIPA -- it was in the SIPA
4 proceeding, but that actually I think makes this claim
5 harder, because in that instance that entity did have it,
6 and the allegation was that the SIPA entity there had been
7 grossly negligent and had willful misconduct and had
8 breached the contract by letting itself go broke basically
9 was the allegation. And that was under Illinois law, but we
10 cite cases on page 10 of our reply that say that Illinois
11 law is not materially different from New York law. And the
12 claimant did set up its gross negligence and willful
13 misconduct allegations a little differently here.

14 Here there is an effort to plead fraud, and I'll
15 talk about that directly, we don't think that pleading is
16 adequate, but it doesn't work in any event we think to get
17 around it had restriction.

18 Your Honor, if you think about force majeure
19 clauses, I mean this clause covered things like terrorism
20 and war, and there's always going to be some allegation that
21 an entity that has a terrorist attack could have had better
22 security or that something could have been done that might
23 have prevented or that the parties that were doing business
24 with the business should have been warned that they were
25 exposed to a terrorist attack or something else, these broad

1 force majeure clauses are designed to deal with a category
2 of loss and not a specific cause of that loss. This
3 includes things like nuclear war.

4 So in essence a SIPA proceeding is the equivalent
5 of a war event in this instance, there's just no ability for
6 anybody else to deal with those securities while SIPA has
7 them tied up and they're in control of the court.

8 So we think that Judge Glenn properly recognized
9 that that clause included willful misconduct and gross
10 negligence, and frankly we think the same would be true if
11 there were fraud that induced a party to continue to do
12 business, which is essentially what their allegation is
13 here. All of those are contributing causes, but it's not
14 about the cause, it's about the category of loss.

15 So we think that is the simple answer and it takes
16 care of everything.

17 They do argue that their claim is based on
18 prepetition actions with LBHI, but whether that's true or
19 not the losses that resulted were directly or indirectly
20 caused by government restrictions, suspension of trading, or
21 other conditions beyond Chapter 11 debtor's control.

22 Now Stonehill says that --

23 THE COURT: So even if -- just to focus on that
24 last point.

25 MR. MILLER: Yeah.

1 THE COURT: So even if prepetition, pre-SIPA,
2 August into September of 2008 there was a very full record
3 beyond what's alleged now, a very full record of meetings
4 and conversations and specific promises and showing of
5 numbers -- I'm making this up -- even if there was a record
6 that Stonehill had been actively and affirmatively reassured
7 and led to stay put, not as a fraud claim, but that wouldn't
8 -- it would not have an affect on the effectiveness --
9 preclusive effectiveness of the force majeure clause, right?

10 MR. MILLER: I think that's right, Your Honor.

11 THE COURT: I mean that's what you're telling me.

12 MR. MILLER: Certainly unless the assurance was
13 there's no way you'll ever lose even a moment of access to
14 your security, don't worry about that, we promise -- I mean
15 this is a question of misrepresentation -- well even if
16 there's a SIPA proceeding trading will continue. I mean you
17 could --

18 THE COURT: You could come --

19 MR. MILLER: -- concoct some very specific things.

20 THE COURT: Right.

21 MR. MILLER: But if the assurance was this
22 broker/dealer is regulated, its got lots of money, you've
23 got protection from SIPA, you will get your securities back,
24 that all turned out to be true. The only thing that
25 happened was there was a delay in being able to get the

1 securities back.

2 So all of these assurances about liquidity and
3 about the operations turned out in a sense to be true.
4 There was enough liquidity, everybody's securities came back
5 to them, nobody lost any securities. And parts of the
6 broker/dealer continued to function through the sale of
7 Barclays.

8 So it's not true that, you know, these securities
9 went away, what happened was there was a delay, and there's
10 no allegation that anybody ever said there will never be any
11 delay. I mean, you know, you don't have to worry about it,
12 you'll always have your securities, everything will continue
13 smoothly. The allegation is that there were statements that
14 there was certain amounts of liquidity and basically it was
15 the intention of keep doing business. And I'll explain,
16 even if you didn't have this exculpation clause -- or I
17 really think this is a force majeure clause and there's
18 another exculpation clause in Section 30 -- but --

19 THE COURT: Right.

20 MR. MILLER: -- even if you didn't have Section 29
21 or Section 30 I don't think the allegations here of tort or
22 contract work -- and I'd like to talk about that briefly
23 now.

24 THE COURT: Sure.

25 MR. MILLER: So -- but I think the force majeure

1 clause is a simple complete answer, and I think Judge Glenn
2 applied it broadly, and I think his approach to that clause
3 where he said, look, hanging tort allegations around it or
4 saying there were torts before or torts after doesn't change
5 the fact that the category of loss was in -- between
6 sophisticated parties was excluded from recovery. And I
7 notice the point is made that SIPA also precludes this kind
8 of recovery. I mean it's statutory. So that's consistent
9 with something in the SIPA proceeding. That's consistent
10 with something that Congress did.

11 Now there's also a limitation of liability clause
12 in paragraph 30. It expressly excludes gross negligence or
13 willful misconduct. That is there's a critical difference
14 though because it's much broader in terms of the actions,
15 and it deals with categories of actions that include
16 "execution, clearing, handling, purchasing, or selling
17 securities, commodities, or other property, or other action
18 except for gross negligence or willful misconduct." So it
19 basically is a very broad exculpatory clause, and it covers
20 any action whether it was beyond the control or not beyond
21 the control.

22 So there's a real qualitative difference and
23 that's the reason there are indifferent provisions, and
24 Judge Glenn did not -- there's a similar two clause
25 arrangement in MF Global, he didn't import the gross

1 negligence or willful misconduct as an expectation to the
2 other clause. It's not in Section 29, it's only in
3 Section 30.

4 THE COURT: Well that supports --

5 MR. MILLER: Yes.

6 THE COURT: That seems to support your
7 characterization of the first as a force majeure and the
8 second as a more ordinary exculpation.

9 MR. MILLER: Yes. One is sort of broad and thin
10 and the other one is very narrow and deep, Your Honor.

11 The first one is very narrowly defined to certain
12 things that I think -- traditionally in law school when I
13 was there they call those acts of God, but things that are
14 pretty much beyond human control to some extent, and that
15 includes the government deciding that somebody has to shut
16 down and locking down its assets.

17 So again, we think that that takes care of
18 everything. But even if Section 29 did not exist these
19 claims are still insufficient. And let me start with some
20 of the imaginative contract theories.

21 First of all Stonehill says that the reference to
22 Lehman Brothers and the broad definition makes LBHI and
23 other affiliates jointly and severely liable, which is by
24 the way more of a tort concept than a contract concept.

25 The only provision that it posts a duty to hold

1 and return securities however is paragraph 21 of the PB
2 agreement, and it imposes duties only on LBI, and indeed the
3 Court can take judicial notice of the fact that only LBI is
4 licensed to hold and trade and deal with securities. The
5 other Chapter 11 debtors were not licensed as
6 broker/dealers.

7 New York law is clear, as stated in the Abundance
8 Partners case that we cite on page 10, that "where the plain
9 language of a contract signed by multiple parties indicates
10 that only one party has assumed an obligation, only that
11 party will be held liable for a failure to perform." There
12 are other cases that say the same thing. The multiple party
13 allegation only works if it looks like all the parties
14 agreed to perform the whole contract, and here clearly the
15 prime brokerage functions were broken out.

16 Now, there's also an allegation by Stonehill that
17 somehow LBHI should be jointly and severely liable because
18 it received a benefit from the PB agreement because it was
19 the parent corporation of LBI. Well this of course just
20 jumps over the whole alter ego doctrine and says, well,
21 gosh, if you might have gotten a dividend from this benefit,
22 from this business you're liable for all these contracts.
23 They cite no law and there is no law.

24 Now let me talk about the bailee argument. It's
25 interesting.

1 It is first of all based on a misreading of a
2 clause and contract. What the contract clause really says,
3 Your Honor, is that LBI holds as a bailee for the benefit of
4 other Lehman entities.

5 As the examiner found, and Stonehill admitted, the
6 purpose of this kind of clause was to protect Lehman
7 entities who were owed money by a brokerage customer by
8 allowing them to treat those securities held by LBI as a
9 form of collateral. Basically it was a cross-
10 collateralization arrangement. So (indiscernible) got a
11 loan from LBCC or some LBDP or one of the other entities
12 that was in the banking business and they had securities,
13 LBI was holding for their benefit and they could claim on
14 it.

15 Now Stonehill reads this clause backwards, it
16 tries to say this makes LBHI a bailee for the benefit of the
17 brokerage customer, which is not the way the clause reads.
18 And so it says at least it's an implied bailor. But the
19 admitted facts are here that LBI was the only entity that
20 held securities. There's -- as I said, there's no
21 allegation that any other entity held it, and we cite cases
22 in our brief, our reply on page 13 for the clear proposition
23 under New York law that there can be no bailment without
24 possession by the bailee.

25 THE COURT: So this fits into the category of LBHI

1 has a relationship in which its counterparty is obligated to
2 post collateral.

3 MR. MILLER: Yes, Your Honor.

4 THE COURT: LBHI can't hold the securities.

5 MR. MILLER: Yes, Your Honor.

6 THE COURT: LBHI turns around to LBI and says,
7 here, hold these securities for us as our agent or as our --

8 MR. MILLER: I think what it really says is that
9 LBI holds the securities as a bailee and it holds it as a
10 bailee, but the beneficiary of that bailment is not just the
11 bailor, but also other entities. In other words one can
12 post a bailment --

13 THE COURT: But not the counterparty to the -- but
14 not the counterparty --

15 MR. MILLER: Right.

16 THE COURT: -- whose securities they actually are.

17 MR. MILLER: It doesn't say that -- it would be
18 like an escrow agent.

19 THE COURT: Right.

20 MR. MILLER: Let's say that two parties to a real
21 estate contract put money into escrow and the contract says
22 that the escrow agent holds as the bailee for both the buyer
23 and the seller, and under the circumstances that does not
24 make the buyer or it does not make -- yes, it doesn't make
25 the buyer who maybe a beneficiary of this money in escrow a

1 bailee or the seller. It means that it is a beneficiary of
2 the bailment, that's really what's happened here --

3 THE COURT: Got it.

4 MR. MILLER: -- mechanically, I believe, Your
5 Honor.

6 So, I think again, creative, but it doesn't fit
7 the facts.

8 Now, there's also an agency allegation, and this
9 is really another way around alter ego. The conclusory
10 allegation that "LBHI had the ability to influence and
11 control LBI, its wholly-owned subsidiary, as well as other
12 Lehman entities, including with respect to the Lehman
13 entities' obligations under the prime brokerage agreement."

14 Now again, that's just to say that would make
15 parent corporations liable for every contract of their
16 subsidiaries and subsidiaries of subsidiaries if that were
17 the law. They don't have any cases for it. It doesn't
18 work.

19 There's a UCC claim that has to do with failing to
20 hold securities in an account that is protected from other
21 creditors, and this is again creative, it doesn't have
22 anything to do delay and returning securities, it has to do
23 with making sure the securities were returned. Here the
24 securities were returned. And again, there's no indication
25 that LBHI or any of the others could do anything to make

1 sure what account LBI used to hold these securities. So the
2 UCC claim doesn't add anything.

3 Again, all of these contracts claims are also
4 resolved by your Section 29 or 30, which they would be
5 actions, and if they got the wrong account it wouldn't
6 necessarily be willful misconduct or gross negligence. So
7 they're also swept up by Section 30, the broad exculpatory
8 language.

9 Now let's talk about the tort claims.

10 There are two events. There was an earnings call
11 on September 10th and an alleged conversation of Mr. John
12 Wickham, whose employer is not clearly identified by
13 Stonehill, and we'll come back to that in a moment. LBHI
14 has shown that the September 10, 2008 earnings call had
15 extensive disclaimers and cautionary language, that's in
16 paragraph 55 of the objection. Stonehill has not responded
17 at least that I could find to the argument that this
18 language eliminated reasonable reliances as a matter of law.
19 We think it did. It was future events, it turned out to be
20 wrong, they didn't plan to go into Chapter 11 a few days
21 later, and they certainly didn't plan for the SIPA
22 proceeding to happen on the 19th. But that's not actionable
23 because reliance on that was not reasonable.

24 Now, Mr. Wickham made certain statements that are
25 -- and they're outlined in paragraph 39 really of their

1 response, and just to outline what they say about this.
2 They -- and they talk about the intent, and I want to
3 suggest to you that this is first of all fraud by hindsight,
4 and second, it does not plead specific intent for
5 Mr. Wickham.

6 What they say is the proofs of claim allege that
7 Lehman Brothers' "misrepresentations were intended to
8 convince Lehman Brothers' customers and counterparties in
9 general and SCM in particular of the financial stability and
10 health of Lehman Brothers despite the fact that Lehman
11 Brothers' officers knew or should have known that there were
12 substantial risks that Lehman Brothers liquidity and capital
13 may not continue to support its operations." That the
14 liquidity and capital may not continue to support its
15 operations, that's what they allege.

16 Then they say, skipping a citation in
17 paragraph 40:

18 "The proofs of claim further allege that only a
19 few days after Lehman Brothers' direct misrepresentation to
20 SCM regarding Lehman Brothers' liquidity and financial
21 condition 'the debtor commenced its Chapter 11 case and LBI
22 commenced its SIPA proceeding.'"

23 Well, Your Honor, this is classic fraud by
24 hindsight. Some good things were said at some point and
25 then a bad thing happened, therefore you must have known

1 this bad thing was going happen and you must have lied to us
2 about it, or otherwise, you know, the bad thing would not
3 have happened, you had to know it was coming. That does not
4 under any kind of pleading, and certainly under rule 9,
5 which we belief does apply to allegations of fraud as well
6 as allegations of gross negligence, we don't think that that
7 raises either an allegation of falsity sufficiently, or more
8 importantly, Your Honor, it doesn't allege adequately the
9 intent of the speaker for fraud.

10 An element of fraud is that the speaker knew or
11 was reckless in knowing that the statement was false when
12 made. And although intent can be pleaded generally, there
13 has to be a motive that is clearly pleaded at that time, and
14 there must be more than the motive that the speaker wanted
15 to do things that business people always want to do like
16 earn fees or make a profit.

17 And so even if we treat the response as a
18 supplement, this is fatally deficient to allege that
19 Mr. Wickham had knowledge that his alleged statements were
20 false or had a motive to mislead. And I'd like to cite two
21 cases that I think are not in our brief that I've since come
22 cross that I think deal with this well. One is the Wori,
23 W-O-R-I Bank versus RBS Securities case, 910 F.Supp.2d 697,
24 Southern District of New York 2012. It says:

25 "A general statement of knowledge under Rule 9

1 requires either one, a showing that the defendant had a
2 motive and opportunity to commit fraud, or two, allegations
3 of strong circumstantial evidence of conscious misbehavior
4 or recklessness."

5 Further the plaintiffs cannot cite -- and I'm no
6 longer quoting the case, Your Honor -- but further
7 plaintiffs cannot satisfy the motive requirement "based on
8 motives possessed by virtually all corporate insiders,
9 including ... the appearance of corporate profitability or
10 the success of an investment." And that's a quote actually
11 from Novak, N-O-V-A-K versus Kasaks, K-A-S-A-K-S, 216 F.3d
12 300 at 307, Second Circuit 2000.

13 The Wori bank case that I just cited at page 703
14 has a similar quotation. It says, "A general profit motive
15 such as the motive to earn fees ... is not sufficient to
16 show fraud."

17 It would go to the specifics in the claim and the
18 response what Stonehill alleges as motive is "the purpose of
19 these representations was to induce Stonehill to refrain
20 from demanding the returns of its assets held by LBI and
21 other Lehman entities and otherwise taking actions to
22 promptly reduce its commercial exposure to Lehman Brothers"
23 at a time when the senior executives of Lehman Brothers knew
24 the enterprise was on the verge of collapse.

25 Again, Your Honor, this is merely an allegation

1 that they were being encouraged to keep doing business, and
2 that does not have the necessary motive and intent
3 allegation under Rule 9 to allege fraud.

4 Now, it's important also another defect in terms
5 of this fraud pleading, is that Stonehill does not say which
6 executives it's talking about, and it's not offering any
7 allegation that John Wickham specifically knew the
8 enterprise was on the verge of collapse. This is the
9 problem with group pleading of fraud.

10 Under Rule 9, which again we believe and cite
11 cases that does apply, you can't just say a bunch of people
12 had certain knowledge and certain of those people made some
13 statements and therefore there's a fraud. You have to say
14 the people making the statement knew the fraud.

15 We cite a number of cases in our reply that a
16 group allegation of fraud without an identification of which
17 entity committed the fraud is insufficient, and there are no
18 specific allegations that Mr. Wickham himself had knowledge
19 his statements were false. This is clearly a group pleading
20 about Lehman Brothers' executives generally, it also does
21 not identify which debtor. They just sued a myriad of
22 Chapter 11 debtors.

23 When you put this together, Your Honor, even if
24 you didn't have the force majeure clause, which we think
25 takes care of it, Stonehill has not asserted a tort case

1 that can rise to the level of gross negligence or willful
2 misconduct or fraud. And I might add that it has not
3 alleged the kind of gross negligence or willful misconduct
4 facts having to do with -- or a reckless disregard of the
5 truth or the like.

6 So -- and we think by that way that chapter --
7 paragraph 30 of the prime brokerage agreement takes care of
8 negligent misrepresentation.

9 And there's also an interesting little duty
10 problem they have with neglect misrepresentation, because
11 they don't allege who Mr. Wickham worked with they either
12 have, as we believe the facts would show, but we don't have
13 them in the record, that Mr. Wickham was an LBI employee in
14 which case that wouldn't be the problem with these debtors,
15 or if Mr. Wickham did have something to do or had worked for
16 LBHI he didn't have any duty to them. This would be in
17 essence asking a stranger for opinions.

18 I don't think those are the facts, but the fact is
19 if you go in the Apple store and ask an Apple employee do
20 you think I ought to buy Apple stock and he says to some
21 customer, yeah, I have it myself, and the guy goes out and
22 buys Apple stock and tries to sue Apple, the answer that the
23 customer was just walking in -- or perspective customer just
24 walks in off the street, asks somebody for directions on the
25 street, is 6th Avenue over there and they give you the wrong

1 directions you can't sue them. So if Mr. Wickham actually
2 worked for another entity they didn't have a -- weren't --
3 didn't have a special relationship with. And they get back
4 to this bailment story is their special relationship. They
5 don't have any duty for negligent misrepresentation as well.
6 I think that's a technical point.

7 THE COURT: You're also asserting that any
8 reliance was not reasonable, right?

9 MR. MILLER: Yes, Your Honor, absolutely.

10 THE COURT: Separate argument, right?

11 MR. MILLER: Separate argument, Your Honor. What
12 we think -- essentially they have not pleaded any of the
13 elements adequately, or as a matter of law when you look at
14 the facts and take out the conclusory allegations, they have
15 to use words like misrepresented, they don't -- they have to
16 have facts to meet Rule 9, and they do do who, what, when,
17 and where, but they don't do why or what the person knew,
18 and they don't do intent and they don't do reasonable
19 reliance. They don't have all the elements that they would
20 need.

21 Now finally, Your Honor --

22 THE COURT: So let me give you another --

23 MR. MILLER: Yeah.

24 THE COURT: -- hypothetical.

25 MR. MILLER: Yes, Your Honor.

1 THE COURT: Purely hypothetical, obviously.

2 I think everybody our age can recall early
3 September in 2008 what it was like.

4 MR. MILLER: Yes.

5 THE COURT: Hypothetically if over Labor Day
6 weekend, you know, Mr. Fold had gathered everybody in and
7 said get on the phone, get on the phone, the only way we're
8 going to, you know, gather this is if everybody gets out
9 there and keeps everybody from taking their capital out,
10 right? Get on the -- work those phones. Hypothetical.

11 MR. MILLER: Hypothetical, yes, Your Honor.

12 THE COURT: Okay? Hypothetical. And then that --
13 and then they went and there was the Wickham phone call
14 pursuant to my hypothetical.

15 MR. MILLER: Yes, Your Honor.

16 THE COURT: I think what you're telling me is
17 nonetheless the reliance on the Apple store like
18 reassurance, our liquidity is strong, life is good, stick
19 with us would not have been reasonable.

20 MR. MILLER: We believe that's true, Your Honor.

21 It's also important to understand that they did
22 not allege that as to --

23 THE COURT: Well, I said it was a hypothetical.

24 MR. MILLER: -- what Mr. Wickham said.

25 THE COURT: That's why I said it was a

1 hypothetical, and I'm not trying to make suggestions to
2 Mr. Brilliant on how to improve his pleading, I'm just --
3 I'm trying to understand kind of the --

4 MR. MILLER: I know.

5 THE COURT: -- scope of the legal argument, and I
6 think the legal argument is that reliance on those
7 statements, even if all that stuff had happened that I just
8 made up or not, just wasn't reasonable.

9 MR. MILLER: It was not, Your Honor, and it would
10 have been reliance on essentially assurance of future
11 performance.

12 It also feeds neatly into a doctrine that I want
13 to talk about in a moment, which is that a duplicative
14 assertion that a party is going to perform a contract
15 doesn't give rise to a tort in New York law. But let me go
16 back for just a minute to what the allegation is about
17 Mr. Wickham, because it's really thin.

18 If you look at --

19 THE COURT: It's paragraph 13.

20 MR. MILLER: -- paragraphs 13 and 14.

21 THE COURT: Right.

22 MR. MILLER: Yes, Your Honor. If you've already
23 looked at it, this is apparently what the testimony would
24 be.

25 During a phone call held in early September 2008,

1 shortly before the Lehman Chapter 11 filing, Mr. John
2 Wickham, believed to be head of Lehman Brothers Global
3 Client Services, which again is very vague, and acting as a
4 representative of the Lehman entities -- again, there's no
5 facts to support that other than believed to be -- called
6 John Motulsky of SCM in response to Mr. Motulsky's voicemail
7 message to Alex Kirk -- so this was a response -- believed
8 to be a senior officer of LBHI asking about the Lehman
9 entities' financial stability specifically in connection of
10 Lehman entities' prime brokerage and other commercial
11 relationships with claimant and its affiliates.

12 Paragraph 14:

13 "In response to questions and concerns expressed
14 by Mr. Motulsky regarding the Lehman entities' financial
15 strength and viability, Mr. Wickham sought to reassure
16 claimant through SCM and Mr. Motulsky regarding the Lehman
17 entities' financial condition and the stability of its prime
18 brokerage operation.

19 Mr. Motulsky recalls that Mr. Wickham stated that
20 Lehman had adequate liquidity, because unlike Vera Stearns
21 (ph), they prudently financed its customers with matched
22 funds and had sufficient liquidity from sources it believed
23 to be reliable to meet all of its obligations for a year,
24 even if no financing was available, that it had 12 billion
25 surplus cash and also cited the ability of secured financing

1 from the federal reserve, none of which was used."

2 Let me stop right there, Your Honor. All of those
3 facts could be completely true, they don't allege they're
4 false, they just say there was then a SIPA proceeding,
5 that's all they say. So there's no allegation that any of
6 that is not true.

7 Then it goes on, paragraph 15 and it says:

8 "Mr. Motulsky also recalls that Mr. Wickham stated
9 that Lehman's unrealized depreciation in various assets, one
10 of which was Neuberger Berman, half of which Mr. Wickham
11 stated might soon be sold at a profit to realize value and
12 edit to tangible equity, were more than sufficient to cover
13 possible unrealized losses in its portfolio and provide
14 incremental equity that would be required for a plan spin
15 out of most of Lehman's commercial real estate portfolio,
16 and conveyed a message to Lehman Brothers' prime brokerage
17 operations would continue operating in the normal course."

18 It says here conveyed a message that, and the
19 claimant should be comfortable continuing its customer and
20 counterparty relationship with Lehman Brothers.

21 And then it says a few days after this
22 conversation the debtor commenced the Chapter 11 case.

23 But, Your Honor, again, that's -- there's two
24 categories of allegations. Some of those are future hopes,
25 representations, and beliefs, and you can't reasonably rely

1 on any of that. And the rest of that stuff is not alleged
2 to be untrue. And the fact that they got all their
3 securities back, in fact it's consistent with the central
4 theme of this, none of this says there is no possibility
5 that you'll ever have any break in your trading or that the
6 SIPA proceeding won't cause you a problem.

7 So, again, Your Honor, I think the way this is
8 pleaded it simply does not rise to the level of meeting
9 Rule 9.

10 Now finally, Your Honor, there is a doctrine in
11 New York that tort claims cannot be asserted if they are
12 duplicative of contract claims. Now these cases are cited,
13 among other places, on page 30 of our reply, the doctrine
14 applies perfectly here, because the tort claims of Stonehill
15 are merely contingents that Stonehill treated the earnings
16 call and the statements of Mr. Wickham as assurances that
17 LBI would perform the PB agreement. And when a party says I
18 promise to do this in writing in a contract and somebody
19 calls them up and says you're still going to come out and do
20 this contract aren't you, and they say, yeah, I'm still
21 planning to come out and do it, then they don't do it, you
22 have a breach of contract, you don't have fraud on top of
23 the breach of contract. Otherwise every time somebody
24 breaches a contract, since almost always the contract has
25 other assurances, scheduling, all the rest of this, you get

1 a whole tort case on top of a contract case. And in this
2 that's what they're trying to do.

3 So -- and there's a red herring raised in a
4 Stonehill footnote about whether this doctrine applies if
5 there's no valid contract. These cases really stand for the
6 proposition that if the tort claim is not duplicative of a
7 promise in the contract, if somebody has a contract with a
8 guy to do plumbing and he comes out and misrepresents
9 something about the foundation of their house, the fact that
10 there was a plumbing contract doesn't excuse -- doesn't
11 apply to this doctrine.

12 There's also an economic loss doctrine which we
13 cite in our brief, and that really has to do with concept.
14 That if the loss is the same as the breach of the contract
15 then hanging torts around it by negligent misrepresentation
16 doesn't increase the claim.

17 In summary, Your Honor, this is creative, it's
18 interesting, but it's just not a set of claims that work
19 with this contract and the facts that we have with the Court
20 and we think they're insufficient.

21 THE COURT: All right. Thank you, Mr. Miller.

22 MR. MILLER: Thank you, Your Honor.

23 MR. BRILLIANT: Can I have one moment, Your Honor?

24 THE COURT: Sure.

25 (Pause)

1 MR. BRILLIANT: Good morning, Your Honor.

2 THE COURT: Good morning. How are you?

3 MR. BRILLIANT: Good. Thank you, Your Honor.

4 So, I guess this hearing was a long time coming,
5 you know, two snowstorm delays and --

6 THE COURT: Was it --

7 MR. BRILLIANT: -- we're finally here.

8 THE COURT: I've just -- I've lost track.

9 MR. BRILLIANT: Right. But your chambers was very
10 good about rescheduling. We appreciate that, Your Honor.

11 THE COURT: They always are.

12 MR. BRILLIANT: That's absolutely true.

13 THE COURT: Especially my colleague sitting to my
14 left.

15 MR. BRILLIANT: Your Honor, I'm sure -- you can
16 tell Your Honor has read, you know, the briefs and
17 understand the issues.

18 THE COURT: Sure. Sure.

19 MR. BRILLIANT: You know, it's -- what I'd like to
20 do is just kind of give you a little bit of the statements
21 to what we're here about, because I think, you know,
22 Mr. Miller didn't really talk about that.

23 THE COURT: Well we're here on a sufficiency
24 hearing.

25 MR. BRILLIANT: We're here on a sufficiency

1 hearing, Your Honor.

2 THE COURT: Yeah. I got all that.

3 MR. BRILLIANT: And we're here -- right. And
4 we're here on a -- I know you know that, I don't think
5 there's going to be a lot I'm going to tell you today, Your
6 Honor, that you don't know. It's very clear to me you're
7 very well prepared for the hearing. But we're here on a
8 sufficiency hearing. But we're here on a sufficiency
9 hearing in connection with a proof of claim. We're not here
10 on a sufficiency hearing in connection with a complaint, and
11 most of the cases, especially with respect to, you know,
12 9(d) that are -- you know, that are cited by Mr. Miller all
13 deal with complaints.

14 THE COURT: Uh-huh.

15 MR. BRILLIANT: And as Your Honor knows the Second
16 Circuit in the, you know, the Aetna, you know, case, the
17 Shadow, you know, Gay case, you know, there, you know, Judge
18 Lifland had dismissed, you know, the allegation for setoff,
19 you know, on the basis of pleading in a proof of claim, it
20 went up to the District Court, it was affirmed, and the
21 Second Circuit said, no, a burden of proof of claim just
22 needs to state, you know, that you're -- what the nature of
23 the claim is and if you seek to hold the debtor liable. The
24 proof of claim --

25 THE COURT: Right, but I think the --

1 MR. BRILLIANT: -- the proof of claim did that.

2 THE COURT: Right. I think I can help you out
3 though, because here on top of whatever, you know, the law
4 is, we've got this procedure, right, so that given that the
5 proof of claim got filed and then we lay it on that
6 procedure you might make the argument, I think it would be a
7 good one, that even if you have to satisfy the standard and
8 plead with particularity, ala (sic) 9(b), you should have an
9 opportunity to do that, because the order of things in this
10 case didn't put you on notice that you had to do that,
11 right?

12 MR. BRILLIANT: That's right, Your Honor.

13 THE COURT: So that -- and Mr. Miller didn't
14 address that. I mean his arguments at the podium were all
15 addressed to what -- you know, the merits.

16 MR. BRILLIANT: That's right, Your Honor, and I
17 think you're absolutely right about that, Your Honor. I
18 mean obviously to the extent somehow there was some
19 determination that 9(b) somehow applies because they filed
20 an objection then clearly that would be, you know, putting a
21 retroactive, you know, pleading requirement on a party,
22 which obviously violates due process, and you know, the
23 Second Circuit says in any event even if we had filed the
24 complaint here, you know, the right to replead, you know,
25 should be, you know, given freely.

1 So we would expect -- you know, from a worse case
2 perspective that Your Honor should allow that, but I think
3 we -- I don't think, Your Honor, we need to get there today.

4 THE COURT: Okay.

5 MR. BRILLIANT: Because we filed a proof of claim,
6 and the question is whether it's sufficient.

7 THE COURT: Uh-huh.

8 MR. BRILLIANT: And we think with respect to, you
9 know, the fraud allegations we have alleged more than
10 enough, you know, in terms of the who, the what, the when,
11 you know, and the reliance, you know, and the damages.

12 But I think let me just step back for a second,
13 Your Honor. So, I think we all understand, you know, what
14 we're here about, it's a sufficiency hearing in connection
15 with a proof of claim, and then -- and there's two different
16 types -- as Your Honor knows there's two different types of
17 claims asserted here. There's the contract claim, you know,
18 and the tort claims.

19 And -- but when -- you know, listening to your
20 colloquy with Mr. Miller it's clear that their view is that
21 by virtue of the exculpation provisions, you know, contained
22 in the contract that a broker/dealer, leaving aside the
23 issue of, you know, the different entities here, that a
24 broker/dealer on the eve of insolvency is free to lie to all
25 of its customers to get them to keep their securities in

1 there knowing that they will suffer, you know, loss, you
2 know, after, you know, a bankruptcy filing, and that they
3 can just defraud people, and that the provisions of the
4 exculpation, which say, you know, their view, I don't agree
5 with their view, that -- you know, that a force majeure, any
6 damages caused by -- you know, they view, you know, a SIPA
7 proceeding to be a force majeure. We don't agree with that.
8 But --

9 THE COURT: But so let's go right to it. So how
10 do you distinguish, putting aside --

11 MR. BRILLIANT: Uh-huh.

12 THE COURT: -- your tort claim.

13 MR. BRILLIANT: Right.

14 THE COURT: Just on the contract claim how do you
15 distinguish our facts from MF Global?

16 MR. BRILLIANT: Putting aside, you're saying --

17 THE COURT: Putting aside the tort claim.

18 MR. BRILLIANT: Right.

19 THE COURT: Right.

20 MR. BRILLIANT: Okay.

21 THE COURT: Just what you said was --

22 MR. BRILLIANT: Yes.

23 THE COURT: -- you know, on the eve --

24 MR. BRILLIANT: Yes.

25 THE COURT: -- of a SIPA proceeding --

1 MR. BRILLIANT: Yes.

2 THE COURT: -- our broker/dealers --

3 MR. BRILLIANT: Yes.

4 THE COURT: -- are free to lie.

5 MR. BRILLIANT: Yes.

6 THE COURT: Similar allegations were made in MF

7 Global, and I think -- and you can disagree with me -- I

8 asked Mr. Miller the question, well isn't MF Global

9 different because that was the debtor --

10 MR. BRILLIANT: Uh-huh.

11 THE COURT: -- was the SIPA -- the entity that --

12 MR. BRILLIANT: Yes.

13 THE COURT: -- filed, and here basically

14 Mr. Miller said, well, that's -- our case is a force majeure

15 to that because that was the debtor, this was --

16 MR. BRILLIANT: Yes.

17 THE COURT: -- one step removed.

18 MR. BRILLIANT: Yes.

19 THE COURT: So basic question is, you know, help

20 me out of MB Global --

21 MR. BRILLIANT: Right.

22 THE COURT: -- because I find MF Global frankly

23 very persuasive and on point.

24 MR. BRILLIANT: Uh-huh. Okay.

25 THE COURT: Okay?

1 MR. BRILLIANT: So, I think as Your Honor points
2 out, MF Global deals with the contract claim, not the tort
3 claim.

4 THE COURT: Yes.

5 MR. BRILLIANT: But starting out with I think
6 there's three really important differences.

7 THE COURT: Okay.

8 MR. BRILLIANT: One is the one that you asked
9 Mr. Miller about, which is the fact in MF Global only dealt
10 with the SIPA entity.

11 THE COURT: SIPA, right.

12 MR. BRILLIANT: Not the other entities. And with
13 respect to SIPA policy the policy was you just get back your
14 securities, there's not a policy for other claims. And
15 that's -- and we -- you know, the MF Global opinion really
16 deals with a whole litany of different claimants who raised,
17 you know, different issues, the vast majority of the
18 claimants that are dealt with are claimants who asserted
19 claims other than just for the return of their securities in
20 the SIPA proceeding, and Judge Glenn goes into, you know, a
21 lengthy analysis of the policies of SIPA, which are
22 different in a Chapter 11 case.

23 So the first thing is that issue and his
24 application of the force majeure provision, you know, that
25 dealt with, you know, the SIPA policies and applying it in

1 the SIPA proceeding. So that's the first issue.

2 The second, you know, issue here is that the force
3 majeure provision is very different. There one of the
4 issues in the -- you know, one of the litany of things that
5 were listed was specifically, you know, court orders. It
6 was a much broader force majeure provision which included,
7 you know, language that was broader, you know, than the
8 language that was included in this one. And in our
9 particular force majeure provision, you know, it doesn't
10 pick up, you know, this type of issue.

11 THE COURT: Can we look at it together?

12 MR. BRILLIANT: Sure.

13 (Pause)

14 THE COURT: I'm trying to find it.

15 MR. BRILLIANT: So we're on page -- paragraph 29
16 in the --

17 THE COURT: In the response?

18 MR. BRILLIANT: Well, I was going to go through
19 the contract and then I'm going to pull up the case as well
20 and read the two. But looking at paragraph, you know, 29,
21 which is the extraordinary events.

22 (Pause)

23 MR. BRILLIANT: But it's government restrictions,
24 exchange or market rulings, suspension of trading, war, you
25 know, whether declared or undeclared terrorist acts,

1 insurrection, riots, fires, flooding, strikes, failure of
2 utility services, accidents, adverse weather, other events
3 of nature, including, but not limited to, earth quakes,
4 hurricanes, tornados, or other conditions beyond Lehman
5 Brothers' control.

6 THE COURT: Right. So why doesn't that do it?

7 MR. BRILLIANT: Well --

8 THE COURT: We had a SIPA proceeding, right?

9 MR. BRILLIANT: Right. And a SIPA proceeding is
10 not -- well one it's not something outside of their control.
11 The other thing is --

12 THE COURT: Well how -- hold on. SIPA -- I think
13 SIPA would disagree with you. SIPA gets to decide when it
14 commences a proceeding. How could Lehman Brothers
15 generically have done anything to affect when SIPA decided
16 to commence a proceeding?

17 MR. BRILLIANT: Well, I guess what -- you know, I
18 mean -- we start with the litany -- Your Honor, it doesn't
19 say SIPA proceeding. So a SIPA proceeding --

20 THE COURT: Sure.

21 MR. BRILLIANT: -- would either have to be a
22 government restriction --

23 THE COURT: Suspension of trading.

24 MR. BRILLIANT: -- or a suspension of trading.

25 And I guess the question is, is it, you know, suspension --

1 you know, does suspension of trading mean the New York Stock
2 Exchange closed for a day or does it mean, you know,
3 specifically with respect to, you know, this particular --

4 THE COURT: Was LBI able to trade after the SIPA
5 proceeding commenced?

6 MR. BRILLIANT: No, but -- all right. We can turn
7 -- even if -- and I was going to say, even if Your Honor --
8 but the language is different. If you look at the MF
9 Global --

10 THE COURT: Right.

11 MR. BRILLIANT: -- order language, you know, it
12 talks about, you know, orders of courts, and it's more
13 specifically tailored towards these types of issues.

14 But under -- the third issue, Your Honor, and
15 maybe the most important, is under New York law we all know
16 that exculpation provisions, you know, that -- you know,
17 will not be enforced to the extent that the, you know, the
18 damages, you know, result are willful misconduct.

19 THE COURT: Okay. But that's a general public
20 policy argument with respect to limitations of liability,
21 and if you -- and I know that headings in contracts don't
22 mean anything, I don't know if this one specifically has a
23 clause that says so, but we -- the distinction that
24 Mr. Miller draws between the paragraph 29 events and
25 paragraph 30 events I think has some merit.

1 MR. BRILLIANT: Okay. Well, Your Honor, I think
2 that's -- that goes to an issue of damages, you know, what
3 would the -- you know, the -- he's basically saying that
4 damages, you know, that result from things outside, you
5 know, the parties' control --

6 THE COURT: Right.

7 MR. BRILLIANT: -- pursuant to this are damages
8 that you can't recover. And I guess from a public policy
9 perspective, I mean that just can't be.

10 So what they're basically saying is, you know, a
11 party should be -- you know, should -- you know, a
12 broker/dealer, you know, or its affiliates in this context
13 can do anything they want to do, you know, lie, make
14 misrepresentations, you know, out and out defraud a client,
15 and that if the loss has occurred, in their view directly or
16 indirectly or in part because of, you know, a SIPA
17 proceeding or a government order or something else, that
18 they have no liability for any of those damages, and that
19 just -- in a SIPA proceeding, you know, I understand we're
20 -- you know, why the policies are different there, why Judge
21 Glenn can come to that conclusion. That's not controlling
22 law, it's just precedent, it's on a different agreement --

23 THE COURT: Uh-huh.

24 MR. BRILLIANT: -- in context of the different
25 type of allegation here, but what they're saying is when you

1 really boil it down, you know, to its assets, they're saying
2 that under New York law a contract will be -- a limitation
3 on liability will be enforced even if the damages are
4 caused, you know, unwillful misconduct and fraud of the
5 party.

6 THE COURT: But who's the party? You said -- the
7 hypothetical you're setting up is the broker/dealer can do
8 terrible things and then if they've saved by a force majeure
9 event no damages.

10 Here the allegation is that -- seems to be the
11 allegation that it was somebody acting not in the capacity
12 of an LBI employee but in some other capacity.

13 MR. BRILLIANT: That's right, Your Honor. That's
14 right. Well, you know, I was using -- if you want to say,
15 you know, broker/dealer, you want to say the -- all of the
16 affiliates of the broker/dealer, but that's right, you know,
17 that -- you know, what they're basically saying is that an
18 employee of, you know, the Lehman entities, you know, Lehman
19 Brothers, let's just say, you know, all right, the Lehman
20 entities can defraud parties, they can, you know, tell you,
21 you know, as we allege here we have the liquidity to get us
22 for an entire year, we don't have any problem, we're going
23 to continue our business in the ordinary course, keep your
24 securities here, you know, you're going to be fine, even
25 though they knew or should have known that they were on the

1 verge of insolvency in filing bankruptcy. They knew that
2 they had hired -- someone at Lehman Brothers knew that
3 they'd hired bankruptcy counsel. That they had other issues
4 and that the statements they made weren't true.

5 THE COURT: But this -- now this gets to -- it
6 skips over it, but -- and you can come back to your argument
7 -- but then it gets to the concept that certainly
8 sophisticated market participants and others in that time
9 period they're reading the newspaper and there wasn't a day
10 that went by where people didn't think, wow, Is Lehman
11 Brothers going to make it? That was -- I mean we could put
12 into the record, you know, the Wall Street Journal, the
13 Financial Press.

14 MR. BRILLIANT: Uh-huh.

15 THE COURT: I mean the record would be -- would
16 fill this room of, you know, the doubts and the worries and
17 whatever.

18 So, you know --

19 MR. BRILLIANT: Right. But -- right. But the
20 issue of reasonable reliance is not really an issue for
21 today, that's a question of --

22 THE COURT: No, but it is an issue for today,
23 because Mr. Miller confirmed that part of what Lehman is
24 saying is that as a matter of law, even assuming what -- as
25 true what you alleged, that even more so even assuming that

1 you allege my, you know --

2 MR. BRILLIANT: Uh-huh.

3 THE COURT: -- (indiscernible) conspiracy --

4 MR. BRILLIANT: Right.

5 THE COURT: -- hypothetical --

6 MR. BRILLIANT: Right.

7 THE COURT: -- the reliance wasn't reasonable.

8 MR. BRILLIANT: Okay. And I --

9 THE COURT: And I think I'll ask Mr. Miller on
10 rebuttal, but I think that that's what their position is.

11 MR. BRILLIANT: No, look, I agree that that's
12 their position, and I guess what I'm trying to say, Your
13 Honor, is that's just not, you know, appropriate under the
14 law. You know, the issue of reasonable reliance is a fact-
15 based, you know, inquiry.

16 You know, in some of the cases they cite where,
17 you know, they're talking about reasonable reliance on
18 provisions in a prospectus or reasonable reliance in
19 connection with, you know, provisions in a -- you know, in
20 an advertisement, you can make arguments of this type. But
21 here where there's a conversation, you know, that occurred
22 that was designed to induce Stonehill to keep their -- and
23 that's the allegation here -- was designed to induce
24 Stonehill to leave its securities, you know, at Lehman
25 Brothers, and there's a -- you know, we'll go on to

1 paragraph 16 of the attachment -- but with respect to
2 paragraph, you know, 16 where we say these were
3 misrepresentations, you know, and based upon these
4 misrepresentations Stonehill agreed to leave its securities
5 there.

6 THE COURT: Right. But the other thing that you
7 also say in a footnote I believe -- I think it's in the
8 proof of claim. There's a footnote that says this was --
9 yes, it's footnote 6 in the proof of claim.

10 "Many of Mr. Wickham's comments appear to be taken
11 from talking points Mr. Wickham received from the Lehman
12 entities, the communications with customers, rather than
13 being quote/unquote off the cuff remarks of Mr. Wicket's
14 personal views regarding Lehman's financial condition."

15 So, I think that that rather cuts against your
16 argument and brings me more to the Apple store where
17 generally speaking you're in a distressed situation and you
18 have a crisis PR firm -- again, I'm making it up -- and you
19 have to talking points. Why? Because your phone is going
20 to be ringing off the hook with people who want to know
21 what's happens. So that little footnote kind of cuts the
22 other way. So that's point number one.

23 MR. BRILLIANT: No --

24 THE COURT: Point number two that I wanted to ask
25 you at the top and I forgot, was Mr. Miller pointed out that

1 there was no response to the point about the earnings calls
2 and --

3 MR. BRILLIANT: Uh-huh.

4 THE COURT: -- so the -- their --

5 MR. BRILLIANT: Okay. Well.

6 THE COURT: -- position is that you've conceded
7 that point.

8 MR. BRILLIANT: No, we've --

9 THE COURT: Is that true?

10 MR. BRILLIANT: No. If you look at paragraph 36
11 and 37 of our pleadings we haven't conceded that, and they
12 raise the -- you know, the (indiscernible) caution rule in
13 their reply, not, you know, up front, and I would like to
14 speak about that, because --

15 THE COURT: Okay.

16 MR. BRILLIANT: -- they applied it
17 inappropriately.

18 THE COURT: Keep going. I'm interrupting you --

19 MR. BRILLIANT: No, no.

20 THE COURT: -- way too much.

21 MR. BRILLIANT: But let me just point one thing
22 out on this reasonable reliance issue --

23 THE COURT: Uh-huh.

24 MR. BRILLIANT: -- first. You know, they cite the
25 Dola (ph) versus Wachnek (ph) case, you know, in their

1 papers, and there, you know, I believe it cuts against them
2 rather than for them, the court actually found that the
3 plaintiff's complaint adequately pled reasonable reliance
4 for 12(b)(6), and in reasoning the court found:

5 "Whether or not reliance on alleged
6 misrepresentations is reasonable in the context of a
7 particular case is intentionally fact specific and generally
8 considered inappropriate for determination on a motion to
9 dismiss"

10 I think that's right on point here, Your Honor.
11 Your Honor may be able to put yourself, you know, back to
12 right before Lehman Brothers filed and remember that there
13 was a lot of information, you know, swirling around, and
14 think, well gee, you know, well why would somebody, you
15 know, have agreed, you know, to stay, you know, that may --
16 you know, in my mind I can't see how that's reasonable, but
17 you need to wait, you know, on this hearing, you can't just
18 say, you know, that -- you know, it's not plausible that
19 somebody based upon, you know, phone conversations and
20 information, you know, in the public, you know, reasonably,
21 you know, determined, you know, based upon, you know, what
22 we think is well pled here, you know, misrepresentations,
23 you know, agreed to, you know, keep their, you know,
24 securities at Lehman Brothers. So that's a fact-based issue
25 not to be, you know, decided here.

1 Because, you know, although -- you know, I
2 understand there's, you know -- you know, obviously Judge
3 Peck lived the case for a long time before you did, but
4 you're hearing a lot of --

5 THE COURT: Really?

6 MR. BRILLIANT: -- Lehman Brothers' issues and
7 you're dealing with a lot of different issues over a large
8 time frame. And I understand there's some sense that, you
9 know, that you want to, you know, weigh the different facts
10 or the different allegations and see, but the reality is --

11 THE COURT: No, I'm not -- I'm really not
12 interested in getting reversed by the district court for
13 having decided facts in a motion to dismiss.

14 MR. BRILLIANT: Right.

15 THE COURT: So I'm definitely not going to do
16 that.

17 MR. BRILLIANT: Right. Okay. Thank you, Your
18 Honor. And it could actually, you know, with the --

19 THE COURT: But I am interested -- since you've
20 raised kind of the case as a whole -- I'm interested -- and
21 I mean this in the nicest possible way -- I'm interested in
22 the issue of why nobody else was clever enough to have come
23 up with this.

24 MR. BRILLIANT: Yes. You know, I don't think the
25 answer clever enough is really appropriate, Your Honor. I

1 think -- I can't speak for other people because I don't know
2 what damages they had, what claims they filed, why they, you
3 know, decided to withdraw them, what the debtors may have
4 given them with respect to other things in exchange for
5 doing that or how other people, you know, filed their
6 complaint.

7 All I can tell you is here that, you know,
8 Stonehill suffered extreme loss of, you know, you've seen
9 the allegations, \$150 million or more. I can't -- you see
10 the point. You'd have to add them up. But they suffered
11 extreme loss here, you know, caused, you know, by the, you
12 know, the debtor's misconduct and, you know, after being,
13 you know, in their perspective, you know, fraudulently, you
14 know, induced to stay, you know, at the company and believe
15 that they have, you know, valid claims and decided to, you
16 know, assert them.

17 The fact that others didn't assert them, I can't
18 really respond to that. Clearly in the MF Global case in
19 the SIPA proceeding, you know, there were, it would appear,
20 hundreds of people who, you know, asserted those types of
21 claims and were, you know, overruled by Judge Glen. You
22 know, why other parties didn't do it, don't know. Don't
23 know if the prime brokerage agreements for other parties
24 were different in light of the fact that Stone -- that
25 Newport has virtually the same one would assume that other

1 prime brokerage, you know, clients had similar agreements
2 and could have made, you know, similar arguments.

3 THE COURT: But you have -- Stonehill has an
4 allowed customer claim at Lehman -- at LBI?

5 MR. BRILLIANT: They got (indiscernible).

6 THE COURT: They got by this? Good.

7 MR. BRILLIANT: They have other claims that have,
8 you know, been alluded to, you know, that have not been paid
9 because the securities, you know, weren't there. FX claims
10 and derivative claims. They have other claims at that
11 entity. That's correct.

12 THE COURT: But has a diminution claim been
13 asserted against --

14 MR. BRILLIANT: No.

15 THE COURT: -- LBI?

16 MR. BRILLIANT: No.

17 THE COURT: So that's the exact parallel to MF
18 Global, right?

19 MR. BRILLIANT: That Judge Klein ruled on, but
20 that's not been asserted there.

21 THE COURT: But what I'm saying is that you have
22 not asserted a diminution claim against LBI. You've
23 asserted a diminution claim against LBHI and other Lehman
24 entities other than LBI.

25 MR. BRILLIANT: Let me just -- that's correct,

1 Your Honor.

2 THE COURT: So based on what you just said, why
3 haven't you asserted the diminution claim against LBI
4 consistent with your theory that it's all just Lehman
5 Brothers and on the other end of the phone when I'm talking
6 to, you know, whosever talking with them, it's Lehman
7 Brothers, and he's acting on behalf of everybody. So sounds
8 good. Why don't you assert that there's no diminution claim
9 against LBI? I mean, that ship has sailed, right?

10 MR. BRILLIANT: Well, we're not saying, Your
11 Honor, that, you know, I guess that's not at issue here
12 today, right, because Your Honor's not -- we're not here on
13 the LBI SIPA proceeding and I don't think that the fact that
14 we didn't assert it against LBI in any way, you know,
15 prejudices our ability under our theories and we'll go look
16 at the contract because that's something that I think is
17 really important that Your Honor do, but --

18 THE COURT: But you can't -- SIPA doesn't let you
19 assert --

20 MR. BRILLIANT: But what I was going to say -- but
21 the bottom line is, as I say, SIPA doesn't let you assert it
22 and Judge Blaine said, you know, that SIPA is right about
23 that so, you know, I don't know what, you know, what you're
24 really saying to me, you know, that we should be, you know,
25 raising that claim and then taking that up, you know,

1 assuming that, you know, that it --

2 THE COURT: I'm just trying to line things up
3 between here and MF Global.

4 MR. BRILLIANT: Okay.

5 THE COURT: Because part of your argument is that
6 MF Global's -- I understand it's not binding on me, but it's
7 not dispositive. I shouldn't follow it here. I can't
8 apply it.

9 MR. BRILLIANT: That's right. Our view is this,
10 it's not binding and it's not, you know, dispositive in
11 their differences in the context --

12 THE COURT: No.

13 MR. BRILLIANT: -- their claims are being raised
14 as well as, you know, they say New York law and Illinois law
15 are the same, but we're raising specific New York law issues
16 here --

17 THE COURT: Yes. Okay.

18 MR. BRILLIANT: -- that public policy of New York
19 and New York law does not allow for exculpation for --

20 THE COURT: Okay.

21 MR. BRILLIANT: -- gross misconduct and willful
22 misconduct, gross negligence which occurred here in this
23 situation.

24 Your Honor, let's just turn and look at the
25 contract quickly. I'm sure from the pleadings that you're

1 aware of these things, but I think that, you know, that the
2 contracts, it says very different things --

3 THE COURT: Okay.

4 MR. BRILLIANT: -- than what Mr. Miller would ask
5 Your Honor to find. If you turn to the beginning of the
6 contract, you know, in the preamble it says, "This agreement
7 sets forth the terms of conditions under which Lehman
8 Brothers, you know, (as defined below) will open and
9 maintain prime brokerage accounts in your name and otherwise
10 transact business with you as our customer."

11 Now, it says Lehman Brothers. It doesn't say LBI
12 and it says that Lehman Brothers will open and maintain
13 prime brokerage accounts in your name. The next line says,
14 "In consideration of Lehman Brothers opening a prime
15 brokerage account for you, you agree to the following." And
16 then the rest of the agreement, you know, follows.

17 Now, Lehman Brothers, you know, is defined here as
18 being all the Debtor entities that we filed the proofs of
19 claim against. It's not just LBI. So you start out with
20 the standpoint it's not, you know, they would say, well the
21 only party that agreed to be your prime broker was LBI, but
22 that's not right. It's Lehman Brothers. We agreed to be a
23 customer of Lehman Brothers pursuant to their agreement.
24 And the document, the agreement deals with how the logistics
25 of how Lehman Brothers was going to, you know, provide all

1 those services, you know, to Stonehill, to the customer.

2 And then the agreement, Your Honor, is signed by,
3 you know, the parties to this, you know, it's signed as an
4 accepted and agreed to and it says, "By Lehman Brothers,
5 Inc. as signatory for itself and as agent for the affiliates
6 named herein."

7 So, you know, the party to this agreement is all
8 of the Lehman Brothers' entities, so it is not that this is
9 just a, you know, a contract where LBI, you know, agreed to
10 be, you know, the, you know, the customer. I'm sorry, where
11 LBI, you know, agreed to be the prime broker. It's Lehman
12 Brothers agreed to provide, you know, the prime brokerage
13 services provided herein.

14 THE COURT: I'm just not getting that. I mean,
15 the only entity that could act as a prime broker was LBI.
16 It clearly says that in the first sentence. It says a prime
17 brokerage account opened pursuant to this agreement will be
18 opened at Lehman Brothers, Inc. LBI.

19 MR. BRILLIANT: No, that's right, Your Honor, but
20 I think -- I think, Your Honor, what, you know, what our
21 allegation is, all right, and I think the only fair way, I
22 think, to read the contract, Your Honor, is that this is a
23 contract where Lehman Brothers agreed to provide all of
24 these services and with respect to these issues, LBI is
25 Lehman Brothers' agent for purposes of the prime brokerage

1 account.

2 THE COURT: But it -- I'm just not -- I'm just --
3 I hear you, but I'm just not seeing it that way and it goes
4 back to something that Mr. Miller was talking about which is
5 -- and related to your bailment argument. That is that this
6 would appear to be drafted that way -- again, I'm not making
7 a factual determination, I'm just stating an observation.
8 That when you follow this down to, for example, paragraph 3,
9 security interest and lien registration of securities, to
10 acknowledge a business of all the Lehman entities that they
11 were going to engage in other transactions in which
12 counterparties to agreements with LBSF, LBHI, you know,
13 LOTSI (ph), whoever it might be, we're going to have to post
14 collateral. LBHI or whatever counterparty that was can hold
15 the collateral so that there is this prime brokerage
16 agreement in which it's made clear that when another Lehman
17 entity takes collateral, security, they're going to hand it
18 over to LBI because LBI under the law is the only entity
19 that can hold securities, because it's the only licensed
20 prime broker.

21 So sure, everybody is in here, right, but that
22 doesn't translate into creating -- necessarily translate
23 into creating the sweeping obligations that you say exist
24 that everybody was acting as, you know, the counterparty
25 here for the purposes of the safekeeping, if you will, of

1 Stonehill Securities.

2 MR. BRILLIANT: Your Honor, I think my argument is
3 a little bit more subtle than that.

4 THE COURT: Okay.

5 MR. BRILLIANT: Or sophisticated, which is that,
6 you know, and again, you know, the agreement says Lehman
7 Brothers, all these entities, you know, will open up, you
8 know, will, you know, will maintain prime brokerage
9 accounts. And then it says and you will be a customer of
10 Lehman Brothers. So just give me a moment, Your Honor.

11 THE COURT: Sure.

12 MR. BRILLIANT: Now, I recognize that there are
13 certain provisions where LBI, as the regulated
14 broker/dealer, agreed to open the prime brokerage account.
15 You know, our view is that the way this is set up, and the
16 signatory line reflects this as well, is that these entities
17 were all agents -- or LBI for purposes of setting up the
18 agreement was the agent for Lehman Brothers.

19 So let me give you an example in a different
20 context just to make it a little simpler. So let's say a
21 client, you know, comes to my firm and they want to do, you
22 know, a transaction that involves multinational, you know,
23 transactions. Now, we have, you know, we're actually other
24 than a (indiscernible), we're just one law firm, but some
25 law firms have multiple entities because of, you know,

1 regulated (indiscernible).

2 THE COURT: Right.

3 MR. BRILLIANT: So the client comes in, they hire
4 Deckard and it goes through and it says in the engagement
5 letter you're hiring Deckard, blah, blah, blah, blah, and
6 then it says, you know, partner X, Y and Z of such and such,
7 you know, entity, you know, Deckard, Europe. You know, it
8 doesn't (indiscernible) that way, but it says Deckard Europe
9 and then Deckard Europe will provide the issues in Europe
10 and then there's a, you know, a breach of the agreement.

11 And then the question is, well can you only sue
12 Deckard Europe or can you sue Deckard? Well the way this,
13 you know, and I guess what I would say is you retained the
14 firm and that's what happened here in this agreement, Your
15 Honor, when you read the entire agreement it's very clear
16 that what happened here is Lehman Brothers, the defined
17 entities, you know, agreed to provide all of these services.
18 And what LBI is, is an agent of Lehman Brothers for purpose
19 of providing some portion of the services, but all of the
20 Lehman Brothers' entities entered into this agreement and
21 agreed to provide all of these services with the --

22 THE COURT: But they couldn't have agreed. That's
23 my point. They couldn't have agreed to provide all the
24 services because the only broker/dealer was LBI.

25 MR. BRILLIANT: Right, but, Your Honor, they

1 agreed through their agent. They agreed -- our allegation
2 is that they agreed through their agent, through their
3 subsidiary or affiliate, LBI, to provide the prime
4 brokerage, you know, the prime brokerage services.

5 Now, the presumption, so and let me cite some
6 cases to you, Your Honor, because this came up in their
7 reply brief and so we didn't get an opportunity, you know,
8 to cite this.

9 THE COURT: Now, this -- so under your theory,
10 putting aside there's alter ego issues, putting -- if
11 customer claims had not been paid, if the securities hadn't
12 been returned or customer claims were not paid in full at
13 LBI, under your theory every single customer would have a
14 claim for any loss against other Lehman entities?

15 MR. BRILLIANT: Those who signed this contract
16 with this language, yes.

17 THE COURT: Yeah.

18 MR. BRILLIANT: Yes.

19 THE COURT: Every -- so every single one of them?

20 MR. BRILLIANT: To the extent that they signed
21 this agreement.

22 THE COURT: -- who signed the contract that says,
23 customer account prime -- customer account agreement, prime
24 brokerage Lehman Brothers, Inc., account number. Every
25 single person who signed one of these would have a claim

1 against all the other Lehman entities?

2 MR. BRILLIANT: Well, Your Honor --

3 THE COURT: That's absurd, Mr. Brilliant.

4 MR. BRILLIANT: Well --

5 THE COURT: That can't be what you're telling me.

6 MR. BRILLIANT: Okay. Well, Your Honor, let's
7 just step back, because you're making the assumption that
8 everyone had the same prime brokerage agreement at the time
9 of the filing. The vast majority of customers, I'm sure,
10 were not prime brokerage customers, were just -- just
11 brokerage customers and didn't have a similar, you know,
12 type of agreement. But what I'm telling you is that this
13 particular contract is a Lehman Brothers contract. It says
14 itself it's a Lehman Brothers contract, you know, Lehman
15 Brothers agreed to perform these services that LBI, for
16 purposes of these arguments, was an agent of Lehman Brothers
17 and the other entities made themselves liable for the
18 performance of this agreement by virtue of the signature.

19 Under, you know, Your Honor, as we cite in our
20 brief, under New York law where you have joint parties here,
21 you know, and you don't specifically sever, you know,
22 liabilities, you know, they're deemed to be, you know, joint
23 and severally liable. You know, it's presumed to be. And
24 so there's a, you know, it would have to be, you know, some,
25 you know, evidence to overcome it, you know, at worst, Your

1 Honor, we think it's ambiguous as to whether or not -- we
2 don't think it's ambiguous, we think they did agree to be
3 joint and severally liable, but to the extent they didn't --
4 Your Honor thinks it's not clear because of the, you know,
5 the difference in the language and you think that's
6 ambiguous and would be subject, you know, to, you know, to
7 evidence as to what the intent of, you know, what the intent
8 of the parties, you know, was here.

9 But, you know, their argument, Your Honor, is that
10 since LBI was the only registered broker/dealer, that
11 they're the only party, you know, that could be a bailee.
12 You know, I mean, that's just wrong. I mean, you know, in
13 ordinary everyday life, you know, bailees use agents, you
14 know, to perform their obligations.

15 So I want to just give you a couple of cites that,
16 you know, cases that you can look at, you know, that where,
17 you know, where parties are liable for their, you know,
18 their agents bailment or they're still bailees even though
19 their, you know, their agent was holding the goods, you
20 know.

21 Mays v. New York, New Hampshire (sic) Railroad, 97
22 N.Y. Supp. 2d 909, 1950, you know, there the Court found
23 that an actual bailment exists when there is an actual
24 delivery of the property to the bailee or his agents or
25 constructive delivery comprehending all those acts was not

1 truly compromising real possession have been held by legal
2 construction equivalent to acts of delivery which include
3 symbolical or substituted delivery.

4 Goldman Sachs Mortgage Company v. Natixis 2008
5 N.Y. Misc. Lexus 9849 Superior Court, New York, 2008.
6 Finding that a defendant accepted bailee letters when its
7 custodian agent took possession of mortgage loan documents.

8 Klotz v. Morocco, 288 N.Y. Supp. 684, 1967
9 finding, "Plaintiff established a prima facie case for
10 bailment by proving delivery to defendant's agent and
11 failure to redeliver upon demand." It was reversed on other
12 grounds, but, you know, the proposition wasn't reversed.

13 So, Your Honor, it's -- the idea here that just
14 because LBI was the only broker/dealer means that somehow it
15 was the only one that had these obligations, just it's a
16 matter of law it's not right. The question is looking at
17 the contract itself and trying to discern whether --

18 THE COURT: So if the securities hadn't been
19 returned, you believe that there would be a claim against
20 other Lehman entities, non-LBI Lehman entities for the
21 return of the securities?

22 MR. BRILLIANT: We believe, Your Honor, that, you
23 know, and it's not relevant to this today, right, but we
24 believe that in addition to the diminution claims, if we
25 wanted to, we could have, you know, we did give back, as we

1 said most of the securities but they're joint --

2 THE COURT: But answer my -- answer my question.

3 MR. BRILLIANT: Yes. Yes, we -- I believe they
4 are joint and severally liable.

5 THE COURT: But that's contrary -- that's contrary
6 to a decision that's already actually been rendered in this
7 case by the district court.

8 MR. BRILLIANT: Well --

9 THE COURT: Just --

10 MR. BRILLIANT: That may be, but, you know, but in
11 connection, but I'm saying --

12 THE COURT: This whole theory of --

13 MR. BRILLIANT: But I'm saying based on a -- I'm
14 saying on our contract, these other entities agreed that
15 they would -- they were responsible for, you know, for all
16 of the services here, that they're joint and severally
17 liable. Yes, that's what I'm telling Your Honor. I can't
18 -- I'm not familiar with the other case. I can't tell you
19 was that based on, you know, a specific contract or as a
20 matter of law.

21 THE COURT: It's unfair to ambush you. It's a
22 decision in the First Bank Puerto Rico case by the district
23 court, that I see a connection to here in which it was
24 argued that there was a claim against LBHI in connection
25 with securities held by LBI. I see similarities. It's not

1 on all fours, but in any event we can -- we can move on.

2 MR. BRILLIANT: Right.

3 THE COURT: We're going to have to move on,
4 because I have another group --

5 MR. BRILLIANT: Right.

6 THE COURT: -- of parties here. So let me stop
7 interrupting you.

8 MR. BRILLIANT: Okay. Well, but I do want to
9 answer your questions, Your Honor. Obviously that's better
10 than just droning on. But our -- but our view is that when
11 you read the precursor language, the signature page, you go
12 through the contract itself, that this is a contract where
13 all of the, you know, the Lehman Brother entities agreed to
14 be liable, you know, for all of the obligations.

15 The other thing, Your Honor, is, you know, as Your
16 Honor knows, this is a, you know, this is a form contract;
17 it was, you know, basically adhesion contract. You know, it
18 should be --

19 THE COURT: So what about -- I'm sorry, I'm
20 contradicting myself. What about paragraph 21 though? Look
21 at paragraph 21.

22 MR. BRILLIANT: Yes, Your Honor. But I guess what
23 I'm -- what I'm saying --

24 THE COURT: Okay. So it says LBI is going to act
25 as a prime broker for you and lists all these things. So

1 LBI shall be responsible for settling trades executed on
2 your behalf. So LBI doesn't -- you try to execute a
3 trade -- LBI doesn't settle it because of chaos or because
4 of SIPA or some, whatever, you know, hurricane. You say,
5 ah-ha, LBHI, you're on the hook for that even though this
6 says, LBI, you're the one who's going to settle the trade.

7 MR. BRILLIANT: Right.

8 THE COURT: Under your theory --

9 MR. BRILLIANT: Yes.

10 THE COURT: -- the words on this page don't mean
11 anything.

12 MR. BRILLIANT: No, that's not right at all, Your
13 Honor. They do -- they do, like I said, it's like if you go
14 back to, you know, my analogy where you hire a law firm and
15 they designate certain people will do things. So certain
16 people, you know, agree to do things, but they're agents for
17 the group which are joint and severally liable.

18 Your Honor, I mean, I don't think -- you don't --
19 wouldn't disagree with me if it said in here, right, if it
20 just said in here, Lehman Brothers will provide these
21 services and all the entities agree to be joint and
22 severally liable, you don't disagree with me that that would
23 be effective, right?

24 THE COURT: That would be good.

25 MR. BRILLIANT: Okay. So --

1 THE COURT: I mean, that would be more -- that
2 would be --

3 MR. BRILLIANT: Right.

4 THE COURT: -- that would be clearer, but we've
5 got the opposite here.

6 MR. BRILLIANT: Well, we don't have. That's what
7 I'm saying, we don't have the opposite here, Your Honor. If
8 you go through the document 29 and 30 --

9 THE COURT: Right.

10 MR. BRILLIANT: -- which we've talked about the
11 exculpation and the limitation of liability, they talk about
12 Lehman Brothers shall not, right?

13 THE COURT: Well, is there a statement that says
14 that all Lehman entities shall be jointly and severally
15 liable for all the obligations of the parties under this
16 agreement? Is there something that says that?

17 MR. BRILLIANT: No.

18 THE COURT: No.

19 MR. BRILLIANT: But there's a signature that says
20 they're signing on behalf of all the entities, but Your
21 Honor, it doesn't say either way. That's the point, right.
22 It doesn't say either way.

23 It could also have said -- if you, I mean, if you
24 look at, Your Honor pointed to 21, if you go down to 21, you
25 know, you know, you know, J, or, you know, I rather, you

1 know, the -- you know, it says Lehman Brothers will not be
2 responsible for ex -- or omissions of any executing broker.
3 Now, an executing broker is not any of the other Lehman
4 entities, you know, that's the party that's stands between
5 them.

6 THE COURT: Yeah, yeah.

7 MR. BRILLIANT: But they could have also said, you
8 know, that Lehman Brothers will not be obligated for any
9 obligations, you know, of LBI. It doesn't say that. And
10 New York law, Your Honor, presumes -- you should read the
11 cases we cite in our, you know --

12 THE COURT: Okay.

13 MR. BRILLIANT: -- in our brief. You know, New
14 York law presumes that when parties enter into a contract
15 jointly like this, like all the, you know, the LB, you know,
16 the LBHI and its affiliate entities did, that unless it's,
17 you know, unless there's specific severing language, that
18 they're joint and severally liable. And here there's no --
19 no severing language.

20 Now, the language that, you know, that the Lehman
21 entities point to and that Your Honor is pointing to doesn't
22 say that they're not liable, it just says that there are
23 specific things that these entities will do, but it doesn't
24 say that they're not doing it as an agent, which is if you
25 read the signature block, they say they're signing as an,

1 you know, as an agent for the other entities. Our view is
2 that they were the agent for the entities with respect to
3 those specific issues and therefore they were -- the whole
4 entity was liable for all of the obligations.

5 Like I said, Your Honor, it's not like -- I can't
6 point to something that says they agreed to be joint and
7 severally liable, nor can they point to something that says
8 that they don't. But if you look at the first paragraph,
9 you know, it says, you're a customer of Lehman Brothers.
10 Lehman Brothers. These are the terms on which Lehman
11 Brothers will open a prime brokerage account for you. It
12 doesn't say these are the, you know, that LBI will open a
13 prime brokerage account for you.

14 You're right, paragraph 1 and 21, you know, you
15 know, say something slightly different, but it's how Lehman
16 Brothers as defined below will open an account for you. So
17 the combination of that, the signature, the lack of severing
18 clause, we believe makes them joint and severally liable.
19 At a minimum, you know, we think it's -- and we also think,
20 Your Honor, it needs to be interpreted against Lehman
21 Brothers because it was their form, you know, agreement. If
22 they wanted to say they weren't liable, they clearly could
23 have done it. They put in 29, they put in 30, they put in
24 all kinds of other exclusions, but they chose not to do it
25 and they have to live with it.

1 And they, you know, as Mr. Miller said, a
2 contract, you know, he said, we haven't alleged that there
3 were, you know, any benefits the other Lehman entities, you
4 know, got here, and that's not right, but the bottom line --
5 and in our proof of claim specifically we say, you know,
6 that they did.

7 But the Lehman Brother entities got the benefits
8 of this contract in a whole lot of different ways, you know,
9 the ability to, you know, have, you know, lend securities,
10 do various other things throughout the --

11 THE COURT: Well, that was the whole point.

12 I mean --

13 MR. BRILLIANT: Yeah.

14 THE COURT: They weren't just doing it for fun.

15 MR. BRILLIANT: Right. Right.

16 THE COURT: Everyone wanted to make money.

17 MR. BRILLIANT: And so they took on this
18 additional responsibility because they got benefits for it.
19 And if they wanted to say we're going to get the benefits of
20 all this agreement, including having, you know, you do your
21 prime brokerage work at LBI but not have LBI -- but not be
22 liable for LBI, they -- it was incumbent upon them to put in
23 severing language. Not having done that, it's presumed as a
24 matter of New York law that they are liable and there is
25 nothing in the agreement itself that says that they're not.

1 THE COURT: Okay.

2 MR. BRILLIANT: So --

3 THE COURT: All right. Let me hear --

4 MR. BRILLIANT: Let me just go back to the tort
5 claims quickly, Your Honor.

6 THE COURT: Quickly. Okay.

7 MR. BRILLIANT: I know that this has taken me a
8 long time, but you had Mr. Miller up here a little bit
9 longer than me at this point.

10 THE COURT: That's okay.

11 MR. BRILLIANT: So, Your Honor, with respect to
12 the, you know, to the, you know, the tort claims, the first
13 thing is with respect to the, you know, the speaking, you
14 know, you know, caution rule, which, you know, they raised
15 for the first time, you know, you know, in connection with
16 their reply brief. We don't think that, you know, you know,
17 applies here for, you know, for two -- two reasons.

18 You know, one, it does not apply to facts, you
19 know, or to opinions that incorporate present facts and
20 what's been alleged here were facts that they, you know,
21 they, you know, Mr. Wickham, you know, and in the conference
22 call, you know, well it's really only in the conference
23 call, because the only, the only, you know, caution was
24 alleged in the, you know, the caution is in the conference
25 call. You know, the allegation is that they said they have

1 adequate liquidity and that incorporates present facts so it
2 doesn't apply.

3 Also, the speaking caution rule doesn't apply if
4 the speaker did not have genuinely or reasonably believed in
5 the opinion. You know, so, you know, this is really in the
6 nature of an affirmative type defense, you know, but it's
7 not appropriate here in a 12(b)(6) type context where the,
8 you know, the, where the, you know, they have not alleged
9 that, you know, they say we haven't alleged, you know, you
10 know, that these facts weren't true, that they didn't have
11 the liquidity that they said they did and various things.
12 Well, we do because we say in paragraph 16 that these were
13 all misrepresentations. We, you know, and we also say that
14 the speakers knew or should have known, you know, that, you
15 know, as what's, you know, Your Honor, read in the
16 attachment that there were, you know, there were risks that
17 weren't, you know, disclosed.

18 So it really comes down to, you know, the issue,
19 whether it was adequate pleadings, but the speak of caution
20 rule, you know, doesn't apply in this case. And I would,
21 you know, point Your Honor to Iowa Public Employees
22 Retirement System, 620 F.3d 137, the second thirty - 2nd
23 Circuit 2010, you know, where the Court found a forecast may
24 extrapolate present or historical facts into the future --
25 and I'm skipping a little bit -- but in each instance, the

1 forward looking elements and the non-forward looking are
2 severable. Here, characterizations of MF Global's risk
3 management system, that the system was robust, for example,
4 invite the inference that the system will reduce the firm's
5 risk. However, the speaks caution does not apply insofar as
6 those characterizations communication present or historical
7 facts as to the measures taken.

8 And so basically you can't just say, you know,
9 like they're saying, like we gave up caution so you couldn't
10 believe anything. It doesn't work that way. You know,
11 there are, if you say, you know, it only protects people
12 from future statements and it only protects them for the
13 actual future projections. But if the future statement
14 incorporates current -- the current facts like they do here,
15 like we have adequate liquidity, you know, the -- you know,
16 the --

17 THE COURT: But there's more than we have adequate
18 liquidity, there has to be a, we have adequate liquidity for
19 what, so that the for what is in the future, right?

20 MR. BRILLIANT: Well, but there's two issues. And
21 here, Your Honor, because of the bankruptcy filing being so
22 soon after, I mean, you know, it's not as if, you know, they
23 can say that we had adequate, you know, you know, liquidity
24 on Friday, you know, and then on, you know, on Monday we --
25 on Sunday night we filed bankruptcy. You know, it may be

1 that something changed, but that's -- they -- from a
2 pleading perspective, at this point, Your Honor, there were
3 currently embedded in, you know, there were current facts
4 that were, you know, that were, you know, discussed that
5 people had the right to reasonably rely. You can't just,
6 you know, forward looking statements, you know, are, get the
7 benefit of this.

8 THE COURT: But you're not alleging that in this
9 phone call, there was a statement made that have -- are
10 making it \$100 billion in government securities sitting in
11 an account? There's no -- right? That would be a -- that
12 would be a bad misrepresentation, right?

13 MR. BRILLIANT: Right.

14 THE COURT: What you are -- what you're pointing
15 to are talking points, our liquidity is strong, right?

16 MR. BRILLIANT: All right. Well, Your Honor,
17 there's two different issues here. They're not saying that
18 the conversation with Wickham is protected by, you know, by
19 this (indiscernible) issue, because there was no -- there
20 was no caution, it wasn't an SEC document, it wasn't in the
21 call, so that's not -- they're not alleging that this
22 particular rule applies like that.

23 THE COURT: Right.

24 MR. BRILLIANT: They're just saying with respect
25 to the, you know, the --

1 THE COURT: Earnings call.

2 MR. BRILLIANT: -- the earnings call.

3 THE COURT: Right.

4 MR. BRILLIANT: I guess what I'm saying with
5 respect to the earnings call, you know, our allegation, you
6 know, is that there was misrepresentations of fact that were
7 given in the call and that this does not apply and that this
8 rule, which they raised in their reply brief, just doesn't
9 apply. And if you read the Iowa Public Employees case --

10 THE COURT: Okay.

11 MR. BRILLIANT: -- I think it will be pretty
12 clear. And that's a situation where the district court, you
13 know, applied the law the way they were talking about and it
14 was reversed on appeal.

15 THE COURT: Okay.

16 MR. BRILLIANT: The other issue is, Your Honor, is
17 that with respect to the, you know, the, you know, this
18 issue, the question is whether or not the party, you know,
19 genuinely believed the information to be true. And if you
20 look at American International Group, 741 F.Supp. 2d 511,
21 you know, there it says, you know, that if the speaker does
22 not genuinely or reasonably believe what they are saying,
23 that there are, you know, that, you know, the fact that you
24 give caution doesn't insulate you. You actually have to
25 have genuine belief that what you're saying is true. And

1 we've alleged that, you know, that there are
2 misrepresentations.

3 And as, Your Honor, we point out, Your Honor, that
4 the examiner, you know, said that, you know, Lehman, you
5 know, had, you know, gone to great lengths to make its
6 customers, you know, you know, giving them information. So
7 we believe that there's enough of a factual, you know,
8 record here that, you know, for us to show that, you know,
9 that there was, you know, that there was fraud, you know,
10 you know, here to induce, you know, Stonehill, to continue
11 to, you know, maintain its relationship.

12 And so we just don't, you know, don't think that,
13 you know, that, you know, that, you know, that the pleadings
14 that we have don't adequately represent (indiscernible)
15 issues.

16 And with respect to Wickham, Your Honor, I think
17 it's, you know, they say, well, we don't identify what
18 entity, you know, he was with. What happened was we -- and
19 this was alleged in the, you know, in the proof of claim,
20 you know, Mr. Motulsky called a very senior person at LBHI
21 and then he got a call back from Mr. Wickham, you know, who
22 was calling him back, you know, on -- we -- and this is
23 properly alleged in the proof of claim, you know, that, you
24 know, called him back on behalf of, you know, all of the
25 Lehman entities. You know, he didn't specify specifically

1 which one, you know, he worked for, but as we say we believe
2 that he is a senior executive, you know, in the client
3 services department and he spoke on behalf of all the Lehman
4 entities, you know, you know, to, you know, induce Stonehill
5 to, you know, to maintain its accounts at the company.

6 Your Honor, so I think from our perspective, you
7 know, you know, at the sufficiency hearing, we think the,
8 you know, the proof of claim, you know, adequately, you
9 know, you know, states claims both under contract and as a
10 matter of law to the extent that Your Honor thinks the
11 contract, you know, is, you know, whether or not there's
12 joint and several liability. We think at worst from our
13 perspective, it's ambiguous and we should have the
14 opportunity to do discovery and show that the intention of
15 the parties was that the --

16 THE COURT: But if I apply the force majeure
17 clause the way that Judge Glen did in MF Global and as Mr.
18 Miller suggests, I don't -- we don't get to any of that.

19 MR. BRILLIANT: Well, I think, Your Honor, I think
20 you, you know, that is one way to look at this on the
21 contract side, but I don't think that that's right either,
22 because I think you'd also have to find that there's no
23 allegations that the loss here comes from, you know, you
24 know, the, you know, the willful misconduct.

25 THE COURT: No, no, I'm talking about the 29, not

1 30.

2 MR. BRILLIANT: No, no, I understand, but as a
3 matter, you know, you know, my view, Your Honor, you may
4 disagree --

5 THE COURT: Yeah.

6 MR. BRILLIANT: -- that is a matter of law in
7 interpreting a New York contract that every force majeure or
8 other exculpation provision --

9 THE COURT: Implies it.

10 MR. BRILLIANT: -- implies that it will not be
11 applied in the context where there's been, you know, willful
12 misconduct by the party. And the allegation here is that
13 there was willful misconduct, you know, from the parties and
14 therefore, you know, although that may be an affirmative
15 defense they would raise, they would have to prove that at
16 trial that -- that there was no willful misconduct, you
17 know, such that, you know, that should apply.

18 I mean, absent that, Your Honor, as I said, you
19 know, earlier, what they're really saying is we can defraud
20 you, but if your ultimate damages, you know, relate to the
21 SIPA proceeding, then you're not -- then, you know, we don't
22 have -- then you have no claim against us and that just
23 can't be.

24 You know, in the context that you laid out where,
25 you know --

1 THE COURT: But conversely, if it can be, then I
2 would have a huge crowd of people in the hallway and I
3 don't.

4 MR. BRILLIANT: Well, you won't, Your Honor,
5 because the bar date has passed and you don't have to worry
6 about opening up the floodgates at this point, so that's not
7 an issue.

8 THE COURT: No, no, no, I wasn't making a
9 floodgates argument. I was making a, you know, we're in the
10 greatest city in the world with the smartest lawyers in the
11 world and with all due respect to you, Mr. Brilliant, you
12 know, the case has not been overwhelmed by similar claims.
13 So everybody who was on the earnings call or everybody who
14 had a prime brokerage agreement and everybody who had a
15 similar portfolio of securities, you know, not Apple or not
16 something, you know, securities that didn't weather the
17 downturn in the fall of 2008, they would all be here. And
18 I'm just observing, it's not dispositive --

19 MR. BRILLIANT: Right.

20 THE COURT: -- of anything, I'm just observing
21 that they're not.

22 MR. BRILLIANT: Well, Your Honor, I think, you
23 know, empirical experience as to who brings claims or
24 doesn't bring claims I don't think is really relevant as to
25 whether it's a matter of law --

1 THE COURT: I agree with you.

2 MR. BRILLIANT: -- claims exist.

3 THE COURT: I agree.

4 MR. BRILLIANT: I guess the other thing I would
5 say is, I don't know to what extent other parties, you know,
6 had the type of conversations that Mr. Motulsky had with Mr.
7 Wickham and whether or not there are, you know, other
8 parties who actually have, you know, fraud claims. So --

9 THE COURT: Okay.

10 MR. BRILLIANT: -- so I think --

11 THE COURT: Let me let Mr. Miller get back up
12 because I'm not only keeping the Newport Global folks
13 waiting, but I have another crowd coming in at 2:00. So,
14 Mr. Miller?

15 MR. MILLER: Yes, Your Honor. May I briefly
16 clarify a note from the client and then I'll speak.

17 THE COURT: Yes, of course.

18 (Pause)

19 MR. MILLER: Thank you, Your Honor.

20 MR. BRILLIANT: Your Honor?

21 THE COURT: Yes.

22 MR. BRILLIANT: Thank you. The client points out
23 to me there's -- to answer your question about why other
24 people aren't here. He says it may very well be that there
25 was a very small amount of prime brokerage clients that were

1 LBI rather than LBIE as of the time of the SIPA proceeding
2 and so there --

3 THE COURT: Okay.

4 MR. BRILLIANT: -- may not have --

5 THE COURT: All right. Well, as you point out it's
6 neither here nor there.

7 MR. BRILLIANT: Exactly.

8 THE COURT: It's just interesting.

9 MR. BRILLIANT: But that's what he tells me is,
10 you know, there may not be as many as one thinks there would
11 have.

12 THE COURT: Thank you.

13 MR. MILLER: Ralph Miller again, Your Honor. I'll
14 try to be brief, but let me hit a few key points. First of
15 all, with regard to the SIPA policy, Judge Glen mentioned
16 it, but he didn't rely on any policy finding that SIPA
17 prohibited this as I read his opinion he relied on the force
18 majeure clause.

19 I want to talk just a little bit about this agency
20 and the way the contract's put together.

21 THE COURT: Yeah.

22 MR. MILLER: First, the -- if we look at the
23 contract -- and I have just three or four points to
24 identify. The first thing he referred to is a recital,
25 which is really just a setup for the discussion. It's not

1 an operative provision. And it says, Lehman Brothers is
2 going to be defined below.

3 If you go to the signature block, which is really
4 very informative, it is Lehman Brothers, Inc. as signatory
5 for itself and as agent for the affiliates named herein. So
6 it signs for itself and it also signs for the affiliates.

7 We go over to Paragraph 21 it actually recites the
8 authority for LBI to act as a prime broker by referring to
9 an SEC --

10 THE COURT: Right.

11 MR. MILLER: -- no action letter.

12 THE COURT: Uh-huh.

13 MR. MILLER: And in our reply in paragraph 28, we
14 cited a series of cases that says that an agent cannot --
15 that a principal cannot act in an unlawful way under the law
16 of agency. It's well settled and we cite Minor (ph) v. New
17 York State Department of Corrections Services case. It's
18 well settled -- a tenet of agency that a principal may only
19 do through an agent those things that he may lawfully do
20 personally.

21 And so if -- LBI cannot create the right of LBHI
22 and others to act as principals or agents for things that
23 they're not lawfully entitled to do. It can't make them
24 prime brokers. It can't delegate its prime brokerage
25 responsibilities. So we think the law is clear that it

1 could not be doing that. It's also --

2 THE COURT: But what Mr. Brilliant is saying is
3 that LBI signed and agreed on behalf of the Lehman
4 affiliates that they would be jointly and severally liable.
5 So that's what he says.

6 MR. MILLER: Well, that's what he says, but that's
7 not what the contract says, Your Honor. Because the
8 contract makes it clear that the only prime brokerage
9 relationship is going to be with LBI. It's on LBI
10 letterhead, by the way, and it defines LBI first and it says
11 a prime brokerage account opened pursuant to this agreement
12 will be opened at Lehman Brothers, Inc. And it says, "all
13 transactions, agreements and contracts between you and
14 Lehman Brothers have been entered into in consideration of
15 which other." And then the bailment provision, by the way,
16 which is also relevant to this is in a section called
17 security interest and lien registration and securities. It
18 grants liens in these securities basically for the benefit
19 of other Lehman Brothers entities who may do business.

20 And the bailment language clearly states you
21 hereby acknowledge and agree that all such assets held by or
22 through any Lehman Brothers' entity are held as collateral
23 by such Lehman Brothers' entities' agent and bailee for
24 itself and all other Lehman Brothers' entities and as such,
25 each Lehman Brothers' entity is to will comply with any

1 orders or instructions originated by any other Lehman
2 Brothers' entity with respect to or in connection with such
3 collateral without your further consent.

4 So the purpose and the structure of this is it's a
5 security agreement as well as the creation of a prime
6 brokerage agreement, but it doesn't have any obligations
7 imposed on any of the other Lehman Brothers' entities.

8 This is -- I would suspect, Your Honor, that some
9 lawyer decided that it was better to make them parties than
10 to make them third party beneficiaries. But in effect what
11 you have here is the --

12 THE COURT: Right, but it's what I described.

13 MR. MILLER: Yes.

14 THE COURT: Was this document creates the link
15 between other Lehman entities serving as counterparties in
16 transactions which require the posting of collateral and
17 then those other Lehman entities taking the collateral,
18 handing it over to LBI, because only LBI could -- was the
19 only prime broker in the crowd.

20 MR. MILLER: That may well be true, Your Honor. I
21 think that's a fair way to do this.

22 THE COURT: Again, not deciding facts on a motion
23 to dismiss.

24 MR. MILLER: No, but I think you can look at the
25 contract and again, I don't think the agency argument adds

1 anything to the position. A couple of more points, Your
2 Honor.

3 He said -- the point was made by Mr. Brilliant
4 that this is a sufficiency hearing. That's true, Your
5 Honor, but in effect, the mechanism that's been adopted in
6 this Court is that parties file a claim, there is an
7 objection. This is a very substantive objection. They then
8 file a response.

9 And I started by saying if you take everything in
10 the claim and everything in the response and treat those as
11 essentially a complaint and an amended complaint, we've got
12 the same mechanism as if you had a motion to dismiss.

13 THE COURT: It's a 12(b)(6). It's a 12(b)(6)
14 hearing.

15 MR. MILLER: It's a 12(b)(6) hearing, Your Honor.
16 And he said, well we weren't -- they weren't put on notice
17 on the speaks caution. Paragraph 55 of the objection says
18 Stonehill's alleged reliance on a statement made during the
19 September 10, 2008 earnings call is unreasonable as a matter
20 of law.

21 The call began with a disclaimer advising
22 listeners that statements may contained forward looking
23 statements that are not guarantees of future performance but
24 only represent the firm's current expectations, estimates
25 and projections regarding future events.

1 A subsequent statement was that Lehman Brothers'
2 liquidity position remains very strong -- if they made that,
3 it is at most a mere representation of opinion that cannot
4 support an action for fraud, and we cite some cases. So
5 they were on notice, of the -- although the speaks caution
6 phrase was not used, they were on notice of the unreasonable
7 --

8 THE COURT: Could you address Mr. Brilliant's
9 finale, if you will, that if I don't agree with them, what
10 that means is that there can be outright utter fraud and
11 there's no ability to recover the damages for that in the
12 SIPA claim context.

13 MR. MILLER: Well, Your Honor, I don't --

14 THE COURT: It was a very -- I mean, it's a very
15 sweeping statement.

16 MR. MILLER: It is very sweeping and the problem,
17 Your Honor, of course, in a motion to dismiss context with
18 well what if we'd alleged X and what if we'd alleged Y is
19 they didn't allege X or Y.

20 What they have alleged is essentially that there
21 was this earnings call and I think that's pretty clear how
22 that's dealt with and they allege that there was this phone
23 call with Mr. Wickham.

24 Now, I -- there's more facts around the phone call
25 with Mr. Wickham than anything else, but the facts all are

1 that this was an assurance of performance of the contract
2 and there's no allegation that the statements that were made
3 were known by Mr. Wickham to be false about current facts or
4 that they were -- that they say that it was -- they say that
5 senior executives knew that they were wrong and they say as
6 you pointed out, Your Honor, that Mr. Wickham appears to
7 have been reading talking points.

8 Now, they are saying those talking points must
9 have been wrong because there was a business failure. Now,
10 the fraud by hindsight doctrine is pretty clear that you
11 cannot infer falsity from statements made that are then
12 followed by a bad event. You've got to do more. You've got
13 to say something was specifically wrong.

14 In accounting cases, for example, somebody says
15 there was a clean audit opinion and this business went
16 broke, we're going to sue the accountants. The securities
17 law and the securities law is actually easier because the
18 standards are lower --

19 THE COURT: Right.

20 MR. MILLER: -- than common law fraud. And, Your
21 Honor, Oliver Wendell Holmes famously said that even a dog
22 distinguishes between being stumbled over and being kicked.
23 And fraud is an intentional tort. It carries a lot of
24 consequences including, not in Chapter 11, but normally
25 punitive damages, but it has to do with someone having an

1 intent to harm the other party knowing at the time that it
2 is -- that it's being done that the statements are false and
3 to produce reliance.

4 Wishing and hoping and assuring a party that
5 they're going to -- a party is going to try to perform a
6 contract does not constitute common law fraud, and that's
7 actually New York law. That's the same promise that's
8 already made in the contract. It was already made in
9 writing. And the fact that the person has some doubts about
10 it at a later date does not convert that into fraud.

11 So, your hypothetical, which I'm trying to respond
12 to, isn't this case. Would it be possible for there to be a
13 specific fraudulent statement?

14 THE COURT: Well, the one that I gave the
15 hypothetical of, great news we've got \$100 billion in cash
16 sitting in my office and that was not true.

17 MR. MILLER: That could be. And Your Honor, in
18 the -- if somebody said we've just gotten communication from
19 the FDIC that we have a loan for \$100 billion, it's coming
20 through tomorrow, it's not -- it hasn't hit the news yet and
21 if that's all false, that might -- and the person making it
22 knows it's false, they might get there, but that's not the
23 allegations that have been made here and they've had a
24 chance to do the best they can and they just haven't gotten
25 over Rule 9.

1 And I think again, these general sorts of
2 allegations are going to be possible with regard to almost
3 any business failure. There's almost always going to be
4 some storm clouds on the horizon and somebody who says, you
5 know, are you all going to survive this storm and there's
6 going to be employees all the time who are going to be
7 saying things about, we really mean to, you know, we're
8 getting it together, sales are up, we're doing better. And
9 as this Court knows, this is a little bit of the reason that
10 there may not be -- it's hard to argue that there's time
11 travelers, where are the time tourists from the future.

12 I mean, the argument here, Your Honor, is if this
13 was always a cause of action, how come there are not just
14 thousands and thousands of cases out there. And the answer
15 really is that those kinds of things are not the kinds of
16 representations that create torts and particularly where you
17 have this force majeure clause.

18 And we don't think they cite any case law, by the
19 way, in New York, that says the force majeure clauses cannot
20 cover a cause of loss even though there is some allegation
21 that there was a contribution to that loss through some sort
22 of negligence or misrepresentation.

23 THE COURT: Thank you.

24 MR. MILLER: Thank you, Your Honor.

25 MR. BRILLIANT: Your Honor, may I have 30 seconds?

1 Truly it will be 30 seconds. Your Honor, I just ask Your
2 Honor to look at paragraph 14.

3 THE COURT: Of the agreement?

4 MR. BRILLIANT: No, of the proof of claim.

5 THE COURT: Yes.

6 MR. BRILLIANT: Because the types of allegations
7 that Your Honor was saying would be problematic and that
8 counsel is saying would be problematic were made. We say in
9 the second sentence, Mr. Motulsky recalls that Mr. Wickham
10 stated that Lehman had adequate liquidity because unlike
11 Bear Stearns, it prudently financed its customers with match
12 funding and it had sufficient liquidity from sources it
13 believed to be reliable to meet all of its obligations for a
14 year even if no new financing was available, that it had \$12
15 billion of surplus cash, and it also cited the availability
16 of secured financing from the federal reserve, none of which
17 was used.

18 So they did tell us that they had all of this, you
19 know, this, this money, and that's what we relied on. And
20 as for, you know, the case law, you know, you know, counsel
21 says we didn't cite any cases and I would just refer you to
22 our brief and the MBIA case that we cited.

23 THE COURT: Where was what you just read to me?

24 MR. BRILLIANT: Paragraph 12. The attachment to
25 the proof of claim.

1 THE COURT: No, paragraph 14. Mr. Motulsky
2 recalls that Mr. Wickham stated that Lehman had adequate
3 liquidity.

4 MR. BRILLIANT: Yes. Yes.

5 THE COURT: Okay. Thank you.

6 MR. MILLER: Your Honor, may I have ten seconds to
7 respond to that? And I'm sorry I will be brief.

8 THE COURT: Death by a thousand cuts.

9 MR. MILLER: I hope not, Your Honor. The call
10 with Mr. Wickham was supposed to be early September. The
11 SIPA proceeding was September 19th.

12 THE COURT: Right.

13 MR. MILLER: Lots of things happened between early
14 September and September 19th. The complaint in this case,
15 the claim and the response do not allege that those
16 statements were untrue when made. They allege they turned
17 out not to be true on September 19th. Thank you.

18 THE COURT: All right. I know I have the Newport
19 Global folks waiting with some of the similar issues, but
20 this is a separate matter and I'm going to give you a ruling
21 right now.

22 The contract claims don't survive. I agree with
23 the arguments articulated in the briefs and here today by
24 Mr. Miller with respect to the applicability of MF Global
25 and the lack of any meaningful dispositive distinction

1 between what's alleged here even taking it as true and what
2 was alleged in MF Global. So the contract claims are
3 dismissed with prejudice.

4 With respect to the so-called tort and fraud
5 claims, any claim based on the earnings call is dismissed as
6 a matter of law with prejudice.

7 With respect to the Wickham conversation type
8 claims, dismissed without prejudice to being re-pled and the
9 scope of the re-pleading is consistent with the deficiencies
10 that have been identified by Lehman and to afford Stonehill
11 a full opportunity consistent with its due process rights
12 under the procedures that have been followed in this case to
13 file an amended pleading that complies with the requirements
14 of Rule 9(b) if not specifically applicable, but at that
15 level for the purpose of being able to get to the next stage
16 in these proceedings.

17 So I hope that was clear. And if I could ask
18 Mr. Miller if you could reduce that to an order and share it
19 with Mr. Brilliant.

20 MR. MILLER: Do you have a time for this, Your
21 Honor?

22 THE COURT: I'll leave that to Mr. Brilliant to
23 suggest what works for him, 60 days?

24 MR. BRILLIANT: Sixty days will be fine, Your
25 Honor.

1 THE COURT: Okay.

2 MR. BRILLIANT: And then Your Honor, I assume that
3 we would have some reasonable time to --

4 THE COURT: Sure. You can work --

5 MR. BRILLIANT: -- work out --

6 THE COURT: -- out a briefing schedule --

7 MR. BRILLIANT: -- whatever we think might be an
8 objection.

9 THE COURT: -- on that. And then for the purposes
10 of preserving your appeal rights at that point, I'll write
11 an opinion that explains the ruling today in more detail so
12 that to the extent you wish to take it up on appeal, you
13 have a recent decision. All right?

14 MR. MILLER: And just so I understand, is Your
15 Honor going to enter an order?

16 THE COURT: I'm going to enter an order that will
17 say decision to follow.

18 MR. BRILLIANT: And that will extend the appeal
19 date or --

20 THE COURT: You should put that in the order to
21 make that clear.

22 MR. MILLER: Okay. That's not a final order on
23 that issue.

24 THE COURT: Correct. Right. Right? Does that
25 work for you? It seems to me that just makes sense rather

1 than have you wait some period of time for a written
2 decision and then to restart the process on the re-pleading.

3 MR. BRILLIANT: That works, Judge.

4 THE COURT: All right. In the spirit of moving
5 things along. All right. Thank you so much. This was
6 extremely interesting.

7 MR. BRILLIANT: Thank you for your time, Your
8 Honor.

9 THE COURT: I'm going to take about a seven-minute
10 break and at 12:10 we'll start on Newport Global and I
11 apologize for making you wait so long.

12 (Recessed and reconvened at 12:37 p.m.)

13 THE COURT: Okay. Ready when you are.

14 MR. SMITH: Thank you, Your Honor, Turner Smith
15 with Curtis, Mallet-Prevost, Colt & Mosle. As you may know,
16 we are the conflicts counsel for Lehman Brothers Holdings,
17 Inc. which is the plan administrator, and so I'm here today
18 on the objection to Newport claims filed by Newport Global
19 Opportunities Fund and Newport Global Credit Fund.

20 And, Your Honor, I know you're pressed for time,
21 and I'm going to try to get --

22 THE COURT: No, I'll give you -- I have other
23 folks coming in at 2, but other than that, I'm good, so.
24 And we did have what happened here this morning, so maybe a
25 good starting point --

1 MR. SMITH: Right.

2 THE COURT: -- is to tell me why this is the same
3 or why this is different.

4 MR. SMITH: I've been drawing VIN diagrams in my
5 mind, and I'm trying to figure out where it departs from
6 what you just heard and where it's consistent.

7 Now, obviously the main consistency is I represent
8 Lehman Brothers Holdings, and I am the same group of debtors
9 that Mr. Miller just stood up here and defended quite
10 admirably. So I'm not going to deviate really from any of
11 the arguments that Mr. Miller has made with respect to the
12 agreement, which is by the way, the same prime brokerage
13 agreement that you heard so much about during the Stonehill
14 argument.

15 So very quickly and let me see if I can spot the
16 differences. First and perhaps the biggest is that there
17 are no fraud claims --

18 THE COURT: Right.

19 MR. SMITH: -- asserted in connection with this.
20 So that's headline number one. Headline number two, this is
21 not a diminuation (sic) claim, as you'll see in a moment.
22 What happened is that the Newport folks perhaps were smarter
23 and a little more on the ball than the Stonehill folks, and
24 they actually put in an order to move the portfolio from
25 Lehman Brothers to Credit Suisse, and I'll walk you through

1 steps in just a minute.

2 The securities are, in this situation, happened to
3 be held at LBIE, I don't think that makes a difference
4 between what you've just heard with regard to Stonehill. It
5 does add a different -- an additional agreement called the
6 margin lending agreement, which is an engagement directly
7 with LBIE.

8 And this is, as I just said, not a holder claim.
9 There's no claim here that they were somehow lulled into or
10 seduced into letting things stand as they were. So again,
11 the two claimants are Newport Global Opportunities Fund and
12 Newport Global Credit.

13 They -- each of them entered into the same prime
14 brokerage agreement that you've just seen with respect to
15 the Stonehill agreements. And in addition, they entered
16 into a margin lending agreement with LBIE because as
17 practice was on this account, the securities were often in
18 the custody and under the control of LBIE.

19 Mr. May, who was the declarant on behalf of the
20 claimants, very helpfully put in a supplemental declaration
21 in which he describes a prior instance in 2007 in which they
22 moved a small set of securities. Those were also at LBIE,
23 so there is no claim here that they didn't know that the
24 securities were being held at LBIE in London.

25 So the debtors are 18 debtors, we're not -- LBHI

1 is not at issue on the guarantee claim here. These are
2 strictly contract claims, and they are contract claims with
3 respect to 18 debtors, not including LBHI. And we will get
4 to this later, although because you didn't reach this point
5 in the Stonehill decision, as I heard you -- Your Honor's
6 ruling, you were accepting as the initial gating issue the
7 exculpation, the two exculpation clauses --

8 THE COURT: Yes.

9 MR. SMITH: -- the extraordinary events clause and
10 the gross negligence clause.

11 But it is -- it's important to have in mind as
12 you're thinking about this joint and several liability issue
13 that you heard something about during Stonehill, just what
14 the nature of these 18 debtors are. They're -- these are --
15 not one of them is a prime brokerage -- is able to perform
16 the prime brokerage function.

17 And just to, so you get some comfort on this,
18 among these debtors that are being sued for this enormous
19 obligation because of a mishap that occurred in London in
20 transferring securities, they are included, that is to say
21 Newport folks are suing CES Aviation, which is one of three
22 other or four other CES entities being named as liable for
23 their trading losses. That's a -- these are the companies
24 by which Lehman kept and maintained its aircraft.

25 They've included among the debtors who are

1 responsible for these trading losses, LB Rose Ranch, which
2 is an entity that LB -- that Lehman Brothers created to run
3 a golf course and some other properties.

4 They've included among these debtors as being
5 liable for their trading losses, a Hawaiian hotel operation
6 that Lehman Brothers had separately established under a
7 special purpose vehicle. And they've included among the
8 entities that are responsible for these trading losses, the
9 special purpose vehicle that held the headquarters building
10 up on 7th Avenue -- on 6th Avenue.

11 So if we need to, we will get to that prime
12 brokerage, but I just want you to understand exactly who
13 these defendants are, or who these debtors are that are
14 being tagged with the liability for these trading losses.

15 So I think to get us right to the point, which is
16 the operation of the two clauses that you have accepted, in
17 effect, Judge Glenn's reading of the extraordinary events
18 clause, some people called a force majeure clause or the
19 gross negligence clause. I'm comfortable with either one of
20 those clauses, because as the gating issue it precludes all
21 contract liability.

22 And to illustrate why that's the case, I'm just
23 going to hand up, if it's okay --

24 THE COURT: Uh-huh.

25 MR. SMITH: -- these are the three e-mails, three

1 of the e-mails that Mr. May, the declarant on behalf of --

2 THE COURT: Does counsel for Newport Global have
3 these?

4 UNIDENTIFIED: Yes, I do, Your Honor.

5 THE COURT: Okay. Thank you.

6 MR. SMITH: I previewed those with him before the
7 argument started.

8 I'm doing it this way only because they're out of
9 chronological order in the May declaration. So -- but let's
10 see what this tells us, and I'm have in mind particular this
11 allegation, the gating issue allegation of was there gross
12 negligence on the part of Lehman Brothers, whichever one of
13 these debtors you want to describe.

14 Here's what happens very simply. We are told in
15 the May declaration and we don't have a document, but Mr.
16 May asserts in his declaration that on September 10, which
17 was a Wednesday, he had -- he says in his declaration on
18 page 47, "I instructed Lehman Brothers to transfer all of
19 the Newport funds securities to Credit Suisse Securities."
20 That's all he says, he doesn't attach a document, but we'll
21 take that as true.

22 The securities he's talking about is a very large
23 portfolio of bonds. Just by way of illustration, you can
24 see there's five pages I'm holding up here of attached lists
25 of CUSIPs and securities that were in -- there's probably

1 five and a half or six pages. So that's the portfolio.

2 And on September 10, we're told that Newport has
3 resolved, because there is frankly a rush to the exits going
4 on during that final week, and Newport is awake enough to
5 say on Wednesday, look, I want you to -- so that we accept
6 as having, in fact, happened.

7 So let's just track what occurs next and keep in
8 mind again the standards by which we are to be held, which
9 is a standard of gross negligence, which the case law will
10 tell you, it must be something that truly smacks of
11 intentional wrongdoing and mistake, it has to be a very
12 aggravated set of circumstances.

13 So we know from Mr. May's own e-mail traffic that
14 the next thing that happens is the very next day, September
15 11, a Thursday. In the morning, a Lehman representative
16 sends him an e-mail and says, "I called, but got your voice
17 mail."

18 So right off the bat we know that my guy is on the
19 ball, he is calling to follow-up on whatever instruction was
20 delivered, apparently orally because there is no written
21 instruction the previous day.

22 He then lists what he needs to have in order to
23 carry out the transfer, and item number one, two, three,
24 four, five on that list, you'll see a settlement date should
25 be T plus 2. That's from -- you know, from the reading the

1 papers, that's what this thing is all about. T plus 2 as we
2 show is T plus two business days to settle the trade.

3 So Mr. May and Newport has been told as of
4 Thursday at least, that if they expect this transfer to
5 work, it's going to be on a T plus 2 basis.

6 Turning to the next document, we have which is --

7 THE COURT: What about that last line, "I have
8 been advised the transfer has to be versus payment"?

9 MR. SMITH: Frankly I don't know what that means.

10 THE COURT: Okay.

11 MR. SMITH: The next event is on -- these string
12 of e-mails is the next morning. I take this as a warning
13 from Mr. Rockmon (ph) from Lehman Brothers who is telling
14 Mr. May, "Good morning, Roger. Any transfers initiated
15 today will need to be T plus 2 settlement." So he's told
16 Mr. May, get me a letter of authorization and warning once,
17 not once but twice, it's going to be T plus 2 settlements.

18 And Newport, perhaps not having the crystal ball,
19 and in fact, nobody having a crystal ball at that precise on
20 that Thursday or Friday decides not to do anything, he waits
21 until the very next day, Friday. And he does this at 12:05
22 we see as the next document.

23 Mr. May gets around to preparing a letter of
24 authorization that he was told he would have to provide in
25 order to move to the next step of initiating and completing

1 a transfer on a T plus 2 basis. So that arrives at -- well,
2 it says 12:05. Now, I -- Mr. May is based in Texas, so we
3 can assume that's 1:05 New York time, in other words, London
4 is closed at that hour.

5 So we know from the record that Mr. May has put
6 before the --

7 THE COURT: So let me just pause on the time
8 zones.

9 MR. SMITH: Sure.

10 THE COURT: This says 12:05 p.m. It's emanating
11 from Texas --

12 MR. SMITH: Texas.

13 THE COURT: -- so therefore it is --

14 MR. SMITH: 1:05 in New York.

15 THE COURT: -- 1:05 a.m. New York time --

16 MR. SMITH: P.m.

17 THE COURT: 1:05 --

18 MR. SMITH: In the afternoon on Friday.

19 THE COURT: 12:05 p.m. -- hold on. Yes, it's 1:05
20 p.m. New York time, and therefore, it's in the evening in
21 London.

22 MR. SMITH: Yes, it's five hours, there's a five
23 hour difference.

24 THE COURT: Okay.

25 MR. SMITH: But the point is that by now the --

1 THE COURT: COB had occurred in London.

2 MR. SMITH: Yes.

3 THE COURT: Okay.

4 MR. SMITH: And this was, as we know, a very large
5 portfolio that they were asking to transfer and we also know
6 that going into that weekend, there was a great deal of
7 turmoil. I think everybody would accept that set of facts
8 and the Court can take judicial notice.

9 As of Friday when this -- when the letter of
10 authorization finally arrived to initiate the transfer, the
11 question then becomes what did Lehman Brothers do in order
12 to carry it out.

13 Now, Mr. May also attaches e-mails confirming that
14 the trade got booked on Friday. So good for Lehman, it was
15 on the ball, it got -- when the letter -- as soon as the
16 letters of authorization came in, they booked the trade.
17 But it didn't settle the next day, on Monday, it was
18 actually scheduled to settle on Tuesday, but it didn't --
19 nothing could happen on Monday or Tuesday, because as we
20 know, very early in the morning in London, LBIE went into
21 administration, and PWC came on the scene and things were
22 effectively and completely locked down.

23 And so from that point onward from the perspective
24 of these debtors, or from LBIE's perspective, there is
25 nothing more that could be done, and we had no visibility

1 into what was occurring within the administration of that
2 estate because the PWC's administration then effectively
3 takes it out of our hands.

4 I'm told that the commencement of the
5 administration proceedings was around 8 or 9 in the morning
6 in London, so that means we're talking 3 o'clock certainly
7 in the morning, well before anything else happens at -- in
8 Lehman New York.

9 And besides the point, this was a T plus 2
10 settlement, and if we count the two business days, we're
11 really talking about the commitment being made to complete
12 this transfer by Tuesday and no sooner. So the question
13 is --

14 THE COURT: Is T plus 2 market or was that an
15 extraordinary settlement term?

16 MR. SMITH: It was the -- it's within market.
17 Sometimes it's --

18 THE COURT: It's within market.

19 MR. SMITH: -- T plus 3 frankly, so it's a little
20 bit better. We've seen both. We've cited the Court to an
21 SEC website to show that settling issues are usually counted
22 by business days. And we cited the Court to a case called
23 Shaw v Citibank in which there is -- that practice confirms
24 that it's going to be two days of -- two business days. I
25 think it was three days perhaps in that one instance. But

1 the point is, business days.

2 It doesn't really matter because when you get an
3 order late on Friday afternoon, and you can't -- certainly
4 you can't expect it to be settled until the Monday at the
5 earliest, and by then, no doubt about it, no dispute, LBIE
6 is in lockdown position.

7 And so the question is, what did Lehman, we'll
8 call it Lehman in the general sense now, what could Lehman
9 have done with that state of play on Friday afternoon. And
10 what it did do is it booked the trade, and it had to stand
11 back and wait for Monday morning to arrive. And when Monday
12 morning arrived, events had overtaken them, and it was out
13 of their hands. And there cannot possibly be an argument
14 here that there was gross negligence.

15 You have to remember that also going into that
16 weekend who knew what was going on with Lehman. It wasn't
17 until Sunday, this is all a matter of record, it wasn't
18 until Sunday that Lehman knew that for sure that the
19 Barclay's transaction would fail, and that the Fed wouldn't
20 fund it. But that's really beside the point as well because
21 you have to look at this, the conduct of Lehman for purposes
22 of this gross negligence from the perspective of the guy on
23 the trading desk. And certainly the people on the trading
24 desk didn't know, and it came as quite a surprise to all of
25 them no doubt on Monday morning when the whole world changed

1 for them.

2 So we go back then to the two provisions that
3 you've already analyzed at some length with the Stonehill
4 advocate. We have the forced majeure clause, it's -- or the
5 extraordinary events clause which is I think is probably a
6 more accurate description because it is -- it does, as
7 you've pointed out, fit this set of circumstances to a tee.

8 LBIE had gone into administration. That is the
9 functional equivalent of suspension of trading. If you look
10 at the Judge Glenn's decision in MF Global, it was almost
11 identical language. In MF Global it says suspension or
12 termination of trading, but it's essentially the same thing.

13 So -- and this is clearly written so that if there
14 are events that are out of Lehman's hands, and that
15 certainly is a condition that occurs outside of Lehman's
16 control, that this extraordinary events exclusion would
17 apply, without the need to resort to a negligent standard.

18 We're just as happy applying the paragraph 30 of
19 the PBA, the limitation of liability clause, which says that
20 "Lehman Brothers shall not be liable in connection with the
21 execution clearing handling," which is what this falls
22 under, "purchasing or selling of securities or" -- and some
23 ellipses, "or other action except for gross negligence or
24 willful misconduct."

25 So the very tall order that Newport has in this

1 case, is that it has to convince you, that little series of
2 steps that I've shown you through the e-mails somehow
3 amounts to gross negligence in the handling of those
4 securities.

5 THE COURT: So even if I'm wrong with respect to
6 how I read the force majeure clause, even if --

7 MR. SMITH: Even if.

8 THE COURT: -- even if implied in the force
9 majeure clause is a carve-out, public policy exception for
10 gross negligence and willful misconduct, the point is it
11 doesn't matter because assuming I take as true Newport
12 Global's allegations, there's been no gross negligence or
13 willful misconduct.

14 MR. SMITH: That's exactly right. And just a
15 footnote and I think it's -- it'll be helpful for you just
16 to understand where things are. In one respect, if you're
17 talking about breach of contract and that's all this really
18 is, is just a breach of contract claims, what position was
19 Newport left in ultimately after passage of many years, no
20 doubt, but just so you know, LB -- and they concede this in
21 their papers, they were paid off by LBIE in connection with
22 the administration.

23 What's only -- the only thing that's left for Your
24 Honor ultimately if this were to go forward, would be a
25 differential of \$13 million. Because LBI used one kind of

1 exchange, one exchange rate for the pound sterling as part
2 of its administration, which is \$1.79 to the pound, whereas
3 under the plan, the confirmed plan here, the allowed claims
4 were computed at \$1.56 to the pound.

5 So that results in a \$13 million delta, which is
6 really all that's left. They've been paid in all other
7 respects. Now, I'm not saying that to say that they're
8 crybabies, I'm saying that to point out in terms of the
9 breach of the contract, they are in no worse position having
10 left the securities of LBIE and having gone through that
11 lockdown, they are in no worst position that they would've
12 been had they stayed at LBI, or had been returned to them by
13 some miracle Friday afternoon within hours of them having
14 put in the letter.

15 So I think that's enough to put you into the
16 picture and apply what your rulings have been in Stonehill,
17 and I'll just --

18 THE COURT: But let's talk about the guarantee
19 claim, right.

20 MR. SMITH: Yes, there is no guarantee claim
21 before you.

22 THE COURT: I'm sorry?

23 MR. SMITH: There is no guarantee claim before
24 you, so I'll make it simple. This -- the claims initially
25 included a guarantee claim, and there were objections.

1 THE COURT: Yes.

2 MR. SMITH: As part of the objection process, they
3 raised for the first time in our understanding some
4 guarantee evidence that was not part of -- we didn't believe
5 was part of their discovery. We took the guarantee issue
6 because it looked as though there might then be an issue of
7 fact that we had to get through, and we took it off the
8 table.

9 THE COURT: Okay. I missed that.

10 MR. SMITH: Right.

11 THE COURT: I missed that episode in the story.

12 MR. SMITH: I know it's a --

13 THE COURT: How did we not -- how did we miss
14 that? What should I be looking at?

15 MR. SMITH: So you're --

16 THE COURT: What did I miss?

17 MR. SMITH: I guess it's when -- let me ask one of
18 my associates. It's -- at some point, there's a transition
19 where it is withdrawn. While they look for the docket --

20 THE COURT: Okay.

21 MR. SMITH: -- entry that tells you that --

22 THE COURT: Okay.

23 MR. SMITH: -- there were 19 debtors including
24 LBHI with a guarantee claim.

25 THE COURT: Okay. Just so you know, and I'm not

1 being a crybaby, the aggregate dockets in these cases are
2 probably approaching 100,000 entries. There's no way. Our
3 computers would start to smoke if we tried to follow the
4 docket, so we very much rely on the parties to let us know
5 when something happens like that.

6 If we did and we missed it, I totally apologize.

7 But if --

8 MR. SMITH: My concern is it may have been a
9 little too nuanced, so that may -- which would be our fault,
10 but at least it's good news, you don't have to think about
11 it.

12 THE COURT: Yeah, okay, it's on a --

13 MR. SMITH: There was a notice of withdrawal.

14 THE COURT: Yeah, there was a notice of
15 withdrawal.

16 MR. SMITH: Do you have document 47564?

17 THE COURT: Yes. Yes.

18 MR. SMITH: All right. So that --

19 THE COURT: Which is document number 47,565 --

20 MR. SMITH: Proving your point.

21 THE COURT: -- just to be clear.

22 MR. SMITH: So we've made it simple --

23 THE COURT: Okay.

24 MR. SMITH: -- I think for you.

25 THE COURT: So what is it -- so those -- you're --

1 I'm sorry. Tell me again.

2 MR. SMITH: Okay.

3 THE COURT: You've withdrawn your motion to
4 dismiss?

5 MR. SMITH: We've withdrawn -- there is no
6 sufficiency challenge --

7 THE COURT: To the guaranteed claims.

8 MR. SMITH: -- to the guarantee claim.

9 THE COURT: Okay.

10 MR. SMITH: In fact, I think all LBHI, any claim
11 against LBHI, whether it's guarantee --

12 THE COURT: Okay.

13 MR. SMITH: -- or joint and several liability or
14 anything else.

15 THE COURT: Right. That was efficient because
16 that's what I was going to tell you would've been the result
17 if the argument on the guarantee claim was that survives --

18 MR. SMITH: Okay.

19 THE COURT: -- the sufficiency hearing.

20 MR. SMITH: Yes. I -- that was lurking in our
21 minds and we didn't want --

22 THE COURT: So, Mr. Steel, you won that one
23 without --

24 MR. SMITH: -- to waste your time.

25 THE COURT: -- really breaking a sweat.

1 MR. STEEL: Thank you, Your Honor.

2 THE COURT: All right. So why don't I hear --

3 MR. SMITH: And then the only other issue really
4 is this joint and several liability. I think you've heard a
5 lot about that, and we are in the position.

6 THE COURT: Okay. So that being said though, and
7 let me get back to my -- the question that I was going to
8 ask before I got sidetracked. So the guaranteed claim is --
9 survives a sufficiency hearing.

10 MR. SMITH: It will live beyond this, yes.

11 THE COURT: Okay.

12 MR. SMITH: We're not making sufficiency
13 challenge.

14 THE COURT: Okay. So let's take the allegations
15 as true. Let's say --

16 MR. SMITH: If you --

17 THE COURT: I'm trying to fill in your VIN
18 diagram.

19 MR. SMITH: Uh-huh.

20 THE COURT: If there's a good sufficiency claim,
21 is that precluded --

22 MR. SMITH: If a good guarantee --

23 THE COURT: -- if it's a good guarantee claim, I'm
24 sorry, is that precluded by 29 or 30, or is that a separate
25 claim? If I say to you, I agree with you, 29 and 30 applies

1 even more clearly here than it did in Stonehill, based on
2 what you've taken me through even without even getting what
3 you've taken me through?

4 MR. SMITH: I don't think I can rely on the
5 exculpation. I think the guarantee --

6 THE COURT: The guarantee claims stands on its
7 own.

8 MR. SMITH: I'd have to look at what they're
9 saying about it, but I think that the guarantee would stand
10 on its own.

11 THE COURT: Okay. I think so too, but I -- you
12 know, I was trying to fill in the VIN diagram, but I think
13 the guarantee claim stands on its own.

14 MR. SMITH: Yes, if you look at it as a sort of a
15 blanket guarantee of whatever loss you suffer, we'll somehow
16 make it good --

17 THE COURT: Right.

18 MR. SMITH: -- just come see Uncle LBHI and he'll
19 take care of it.

20 THE COURT: Right. It's not hooked into the prime
21 brokerage agreement.

22 MR. SMITH: That's right. I don't think you can
23 take it up because that comes afterwards.

24 THE COURT: Okay.

25 MR. SMITH: But that's for another day and

1 frankly, I don't think it'll ever occur, because I expect
2 that LBIE will true up that 13 in -- over the course of --

3 THE COURT: Okay. I got it, okay, very good.

4 Thank you.

5 MR. SMITH: Thank you.

6 MR. STEEL: Good afternoon, Your Honor.

7 THE COURT: How are you? I apologize again for
8 making you wait so long.

9 MR. STEEL: Oh, no worries at all. Howard Steel
10 of Brown Rudnick on behalf of Newport Global Opportunities
11 Fund and Newport Global Credit Fund Master. With me is my
12 partner, Andrew Dash.

13 THE COURT: How are you, Mr. Dash?

14 MR. DASH: Pleasure to be in your courtroom, Your
15 Honor.

16 MR. STEEL: Your Honor, I dare maybe snatch some
17 victory on the guaranteed claims from jaws of defeat, but
18 there's a little dispute I think from Mr. Smith's last
19 comments that --

20 THE COURT: Okay.

21 MR. STEEL: -- well, it doesn't matter. Well, it
22 matters a lot to us. We briefed in our response the
23 guarantee issue. We're confident it's a good claim --

24 THE COURT: Okay.

25 MR. STEEL: -- we're very sensitive to your late

1 square ruling that otherwise allowable guarantee claims
2 should be permitted to be allowed. Well, it was just taken
3 off the calendar unilaterally by Lehman. We didn't consent
4 to that. They said in their notice is they're trying to
5 streamline the proceeding, yeah, three hours in, so
6 that's --

7 THE COURT: Okay. So now --

8 MR. STEEL: Your policy -- I just --

9 THE COURT: Now, I'm really -- now, I'm confused.
10 So they -- they're withdrawing their 12(b)(6) objection --

11 MR. STEEL: Right.

12 THE COURT: -- to your guaranteed claim, that's a
13 good thing for you.

14 MR. STEEL: Right.

15 THE COURT: Right. So -- but I'm hearing you
16 complain so I don't understand.

17 MR. STEEL: Well, it's not otherwise allowed just
18 because they're withdrawing the sufficiency challenge.

19 THE COURT: Right.

20 MR. STEEL: We're still in limbo. We'd like the
21 assurances that that guaranteed claim which we think are --
22 is bona fide is designated as allowed.

23 THE COURT: Well, but that's not the next step.
24 The next step is now that it survived a sufficiency hearing
25 and now we're going to have discovery, I suppose, and you're

1 going to go forward. Unless you think that you're entitled
2 to -- and I don't want to again trip over procedure here,
3 but unless there's something in the case management order
4 that suggests otherwise, if you believe that you can make a
5 summary judgment motion. Then under 7056(1) you would ask
6 for a conference and ask to do that. But it feels very
7 facty to me --

8 MR. STEEL: Right.

9 THE COURT: -- particularly on the issue of
10 reliance among others, knowledge, so that's where we would
11 be going next. So they don't win, but you haven't won yet
12 either.

13 MR. STEEL: Great.

14 THE COURT: Okay?

15 MR. STEEL: And I don't mean to trip over the
16 procedures --

17 THE COURT: Okay.

18 MR. STEEL: -- and I'll revisit the procedures. I
19 just wanted some reasonable assurance that they would engage
20 in such discovery and I have a right to --

21 THE COURT: Oh, that --

22 MR. STEEL: -- prosecute and move this claim
23 forward.

24 THE COURT: So, Mr. Smith --

25 MR. STEEL: We've just got the back of the hand.

1 THE COURT: -- you don't disagree with any of
2 that, right?

3 MR. SMITH: No, in fact, I'm waiting for discovery
4 because --

5 THE COURT: Okay.

6 MR. SMITH: -- I'd like to test this claim, Your
7 Honor.

8 THE COURT: Okay.

9 MR. STEEL: Well, I heard the opposite. He said,
10 well, we'll never have to address this claim, so.

11 THE COURT: No, I think he was -- I didn't take
12 the comment that way.

13 MR. STEEL: Okay.

14 THE COURT: And we're not going to wait for that
15 to occur. You've got a claim --

16 MR. STEEL: Okay.

17 THE COURT: -- and we'll go to discovery. Right?

18 MR. SMITH: I'm told that there are some very --
19 there are procedures --

20 THE COURT: Yeah, that's what --

21 MR. SMITH: -- that must be followed --

22 THE COURT: Right, that's what --

23 MR. SMITH: -- and we're following those
24 procedures --

25 THE COURT: That's what I was saying.

1 MR. SMITH: That's what I assumed would happen now
2 till we withdraw.

3 THE COURT: Right. But I think what Mr. Steel is
4 saying, you don't get now to go back into your bunker and
5 wait it out.

6 MR. SMITH: No. And he has the tools, I believe,
7 to --

8 THE COURT: Right.

9 MR. SMITH: -- move things forward.

10 THE COURT: Okay. All right. Great.

11 MR. STEEL: Okay. We'll do that because we have
12 been waiting six and --

13 THE COURT: Okay.

14 MR. STEEL: -- a half years on these claims.

15 THE COURT: Okay.

16 MR. STEEL: I just want to go quickly through the
17 scorecard, Your Honor, because my paramount point is to show
18 you how far outside the MF Global box we are on one hand,
19 and how unique we are from the 200 or so other prime
20 brokers, customers with these contracts. We think we're a
21 special case and the facts actually put us in a different
22 place when you evaluate the exculpation provisions and the
23 joint and several liability question.

24 Your Honor, let me just identify the things that I
25 take issue with on Mr. Smith's statements. He goes, that

1 this dispute, we've already been paid off by LBIE, we have
2 no harm, but then on the other hand, he acknowledges under
3 their confirmed plan, this is at least a \$13 million
4 dispute, that's meaningful.

5 We also have unliquidated claims that if they
6 survive this 12(b)(6) that we'd want discovery on those
7 claims.

8 THE COURT: What are those?

9 MR. STEEL: There's -- I can walk Your Honor
10 through each of the claims, but the unliquidated portions
11 are --

12 THE COURT: You mean attorney's fees and the like?

13 MR. STEEL: Well, things like that, and also for
14 the failure to be able to participate in corporate events
15 attached to the securities. While our securities were not
16 returned after recall, there is ancillary damages. We
17 weren't able to participate in (indiscernible) or rights
18 offering, we weren't able to --

19 THE COURT: So consequential type damages.

20 MR. STEEL: Those type of damages but --

21 THE COURT: Okay.

22 MR. STEEL: -- I think that we could fit under the
23 contract, given I'll show you, and I'll walk you through
24 which sections of the PB agreement they're directly liable
25 on a contract basis.

1 THE COURT: Okay. That's -- but those all go in
2 the bucket of in the guaranteed claim, you would assert
3 those, right, as part of the guaranteed claim? But that
4 doesn't really have a bearing on whether or not the claims,
5 the contract claims survive 29 or 30, right? The existence
6 of those types of -- the allegation of the existence of
7 those types of damages don't change the analysis as to
8 whether the predicate events here get you out of the
9 application of the force majeure or the exculpation clause,
10 right?

11 MR. STEEL: Right. The exculpation still remain a
12 gating issue. I think it comes in on joint and several
13 liability, that's why I raise it now.

14 THE COURT: Okay.

15 MR. STEEL: And we can address it on the back end
16 or whenever Your Honor would like, by looking at the
17 elements of the claims.

18 And that just gets another thing on my scorecard,
19 he passed and said, that we didn't have any claims on fraud.
20 We do have an element of a fraud in the negligent
21 misrepresentation claim with respect to the CapCo bonds
22 which were insurance backing for LBI and LBIE. It's in our
23 proof of claim, it's part of our claims.

24 THE COURT: Can you point that out to me?

25 MR. STEEL: Sure. Let me find the claims. It's

1 in paragraph 3 and 10 of our addendum attached to the myriad
2 proofs of claim. And it relates -- I'm sorry, Your Honor,
3 I --

4 THE COURT: Go ahead, go.

5 MR. STEEL: It relates -- I've got to jump around
6 a little bit. We filed two declarations of --

7 THE COURT: Uh-huh.

8 MR. STEEL: -- Roger May, Mr. Smith referenced
9 that. I know Your Honor has read and is familiar. As
10 Exhibit G to the first May declaration was a document called
11 a 2007 customer asset protection overview.

12 THE COURT: Okay.

13 MR. STEEL: This is a document produced with
14 Lehman Brothers on the top, and throughout it makes
15 references to Lehman Brothers, the credit protection it
16 provides, its PD customers as a holistic enterprise.

17 There's a lot of interesting things in this
18 document, and the declaration goes through how we obtained
19 it, oh, Lehman Brothers gave it to us because we were
20 getting concerned about their credit protection as the
21 credit markets were in the boiling waters.

22 It says a couple of interesting things, and the
23 two most important for this is that one, LBIE benefits from
24 a para guarantee from LBHI, we'll deal with this down the
25 road. And two, that the benefit from this CapCo insurance

1 that any PB customer would have the back stop of a third
2 party insurer, that would satisfy any claims under these
3 contracts.

4 So to the extent we have pled a fraud, a negligent
5 misrepresentation claim that set forth our claim, I just
6 take an issue, and this is just an overview or scorecard, I
7 still think Your Honor's right that the exculpations are the
8 gating issues.

9 THE COURT: But this doesn't take me out of that
10 issue, right?

11 MR. STEEL: No. No.

12 THE COURT: No.

13 MR. STEEL: I just wanted to identify what I
14 thought Mr. Smith was wrong on in terms of the scorecard of
15 issues to address. And then I'll dive into to sort of the
16 overview and the exculpation provisions.

17 Just two more points on Mr. Smith's --

18 THE COURT: Uh-huh.

19 MR. STEEL: -- presentation. He goes on a lot
20 about, well, it was accepted that our securities were at
21 LBIE. Well, there's no evidence to that effect and I'll get
22 into our position. Our declaration sets forth our position
23 that there's no evidence where our securities were at all.
24 That we had a prime brokerage, and you spent time with the
25 Stonehill proceedings saying that under this contract, the

1 prime brokerage agreements opened up at LBI.

2 All right. Well, there was an MLA agreement and
3 that provides certain rights for LBIE -- Lehman affiliates
4 like LBIE to lift and take some of the securities that are
5 pledged for things like loans, right.

6 THE COURT: Uh-huh.

7 MR. STEEL: Well, that's in fact, in our story
8 what LBIE did. It took our client's Newport securities en
9 masse and in violation of application U.S. and SEC customer
10 protection rules, and took them and used them in their own
11 borrowing base and rehypothecated them in trading at the
12 benefit of the Lehman enterprise.

13 All right. Well, the point being is that upon the
14 recall, and it's -- now is an appropriate time to really go
15 through the timeline, Lehman never provided us with any
16 evidence. And since they haven't provided us evidence were
17 our securities were at the time of the recall.

18 And now I think it's a good time for me to address
19 the timeline.

20 THE COURT: Does that last statement have any
21 impact on the gating issue?

22 MR. STEEL: Yes, because it impacts gross
23 negligence. We claim from the get go that the
24 rehypothecation by LBIE in violation of U.S. laws is part
25 and parcel an element of our gross negligence claim because

1 they rehypothecated, because they didn't have effective
2 control of our securities.

3 When we recalled them on Wednesday, the 10th,
4 Lehman was unable to transfer them per our instructions.
5 Right. And I'll walk you through the time, but the --

6 THE COURT: Wait, wait.

7 MR. STEEL: -- gross negligence claim --

8 THE COURT: Wait, wait, wait, wait.

9 MR. STEEL: Uh-huh.

10 THE COURT: You didn't recall them on the 10th.
11 You -- someone made a phone call.

12 MR. STEEL: Right. And --

13 THE COURT: And then at 11:18, Mr. Ramond (ph)
14 told Mr. May, hey, Roger, I need an authorization letter.
15 Right? Now, so the interesting thing is when you get to the
16 authorization letter, which was sent mid-day on Friday, you
17 know, the authorization letter would've taken approximately
18 45 seconds to generate.

19 So --

20 MR. STEEL: Okay. Let --

21 THE COURT: Okay. So that doesn't work.

22 MR. STEEL: Well, let me walk you through how I
23 think it works. I think Mr. Smith sort of spun it a little
24 bit. We filed a supplemental declaration at Docket 48062,
25 that's the one that Mr. Smith referred to.

1 THE COURT: See, I'm already over 48,000.

2 MR. STEEL: I know, oh, my goodness, I can't
3 imagine.

4 THE COURT: What does that say?

5 MR. STEEL: A lot of paper. The supplemental
6 declaration though says, that Lehman was able to make a
7 transfer of many millions of Newport securities in the blink
8 of an eye, in less than a few hours, Lehman was able to
9 effectuate the transfer or recall of the transfer of these
10 securities.

11 So it's unquestioned in the record before Your
12 Honor that they had the ability and they had the capacity to
13 do same day transfers.

14 THE COURT: All right. But -- okay. But now
15 we're -- I mean, and we are on the sufficiency hearing.

16 MR. STEEL: Yes.

17 THE COURT: The documents that you put in show
18 this chain of events that at least commenced in writing with
19 Mr. Ramond's getting back to Mr. May, right. So there's no
20 document back from Mr. May saying, Mr. Ramond, T plus 2
21 doesn't cut it, here's -- attached is our authorization.
22 The authorization doesn't come in for, you know, over
23 however many hours, and then you're up against the weekend.

24 So I don't -- I'm still not following you.

25 MR. STEEL: Right. That gives this credibility

1 this was a more national flowing relationship. There wasn't
2 -- in the contract, there's no set procedures when you want
3 to transfer securities.

4 THE COURT: Do you think it's a good idea for
5 securities to be transferred without a letter of
6 authorization? You don't think so, I'm sure you don't.

7 MR. STEEL: Well, I'm opining on that, I'm just
8 saying that the contract doesn't specify the procedures that
9 were in place for the transfer. The letter of authorization
10 could memorialize something that's already in place, that's
11 already in process.

12 He also pointed -- let --

13 THE COURT: If that existed, Mr. Steel, I think
14 you would've given it to me. I think you would've given it
15 to me and then said, this Ramond -- this is a smokescreen
16 because he didn't need a letter of authorization, he had
17 blanket -- I mean, I can't even imagine how that would work,
18 right. I'm sitting at a desk at Lehman Brothers and I get a
19 voice mail from somebody saying, hey, you know, I'm Roger
20 May, transfer my \$150 million of securities to, you know,
21 Credit Suisse. It's not going to happen, right, so I'm
22 trying hard to follow what you're saying, but I'm not
23 getting there.

24 MR. STEEL: My only point through the supplemental
25 declaration is when there's appropriate authorizations

1 Lehman had the capacity to transfer instantaneously, if not
2 for a short delay. That's my point. So if you're accepting
3 the predicate that September 10th the phone call was
4 insufficient, September 11th, Lehman's acknowledgement that
5 they would transfer the accounts, if that's insufficient,
6 but then on the 12th, they get the letter of authorization
7 and say that the --

8 THE COURT: After --

9 MR. STEEL: -- recall is booked.

10 THE COURT: -- the close of business in London.

11 MR. STEEL: Why does -- why is it only LBIE. We
12 have no proof in the record that LBIE was in control of this
13 when LBI was the prime broker in New York. Every phone
14 call, every fax, every order, every trade went through New
15 York. There's no evidence otherwise.

16 THE COURT: Okay. But then -- so if I meet you on
17 that ground, if I assume, and I wasn't aware that that's
18 where you were going with this, that the securities were
19 actually at LBI not at LBIE.

20 MR. STEEL: We don't know first and foremost.

21 THE COURT: Okay. All right. So suppose they
22 were at LBI, then here comes this e-mail at 12:05 on Friday,
23 September 12th, then you're telling me that then it was
24 gross negligence or willful misconduct for that -- the trade
25 not to have closed in the next four hours and 55 minutes on

1 Friday, September 12th, given everything else that was going
2 on?

3 MR. STEEL: Well, not in the next four hours. The
4 next six years plus. I mean, that's an exaggeration, but
5 let me walk you through the next and the subsequent days and
6 why it turns into a claim for gross negligence.

7 So we're still on that Friday, the 12th, it's our
8 position that Lehman had the capacity when they got the
9 letter of authorization --

10 THE COURT: Can I just ask you to stop, because
11 I'm really just stuck on this LBI versus LBIE --

12 MR. STEEL: Us too.

13 THE COURT: -- issue. And let me ask Mr. Smith, I
14 mean, is this an issue here? Because your whole
15 presentation was keyed off of, and we know what happened
16 next, LBIE went into administration. Am I -- so am I
17 missing something here?

18 MR. SMITH: No, Your Honor. The agreement with
19 the parties included placing securities at LBIE, in fact,
20 there's a margin lending agreement for that purpose with
21 LBIE.

22 THE COURT: Okay. So two separate issues. One,
23 where were the securities actually?

24 MR. SMITH: Oh, as to that, no doubt. Whether
25 they say they knew it or not, there is no doubt they were at

1 LBIE. Because that's who paid them. They made a claim in
2 the LBI administration and got paid by LBIE.

3 THE COURT: Oh, that's an excellent point. You
4 made a claim in the LBIE case.

5 MR. STEEL: We made a claim against LBI also and
6 the Chapter 11 debtors.

7 MR. SMITH: And I was just reminded, that they
8 made a claim in the LBI case.

9 THE COURT: Yes, he did.

10 MR. SMITH: And it was disallowed.

11 THE COURT: Correct because --

12 MR. STEEL: Only because it was part and parcel of
13 a 9019 between the two estates, LBI and LBIE.

14 THE COURT: Okay. Let's not be cute. As you're
15 standing here today, do you know where the securities were?

16 MR. STEEL: We do not. And I have never seen any
17 evidence of where the securities physically were located on
18 the 12th.

19 THE COURT: Well then, you know, we have a huge
20 problem because then if 9019 or no 9019 there are standards,
21 and to the extent that the securities were not at LBIE, then
22 that shouldn't have been an allowed claim. I mean, I'm just
23 -- now, I'm really confused.

24 MR. STEEL: Well, Your Honor, we always thought we
25 had an allowed customer claim against LBI. We took

1 extensive discovery. We were here on the first day, I see
2 Hughes Hubbard colleagues here, we were a hornet in their
3 nest. I mean, we buzzed, buzzed, buzzed that -- the SIPA
4 trustee of the obligation of a term and securities because
5 of what this contract says that we're a prime brokerage
6 customer of LBI, right.

7 THE COURT: Okay.

8 MR. STEEL: When it came to post-petition, three
9 years in when LBI and LBIE negotiated a settlement between
10 the two massive estates --

11 THE COURT: Okay.

12 MR. STEEL: -- we weren't in a position to say,
13 oh, we want to get our securities still back from LBI when
14 we're standing to receive an allowed claim against LBIE
15 because the market was --

16 THE COURT: Okay. I mean, maybe this is much ado
17 about nothing. To the extent that the securities were at
18 LBI, then the point that the administration occurred on
19 Monday becomes beside the point. But to the extent that the
20 allegation is that the securities were actually at LBIE, and
21 LBI didn't have the authority to transfer -- to
22 rehypothecate them to LBIE, then I still don't think that
23 solves the general problem of the applicability of the force
24 majeure or the exculpation provisions.

25 MR. STEEL: All right. Let me walk you through

1 the rest of the timeline and --

2 THE COURT: Okay.

3 MR. STEEL: -- I'll walk you through how we're
4 outside the exculpations.

5 Mr. Smith makes a lot about T plus 2. I still
6 don't think that there's -- because they cite to a rulebook
7 on the purchase and sale of securities, that's a far
8 different thing than the recall of your property.

9 Again, I think it's belied that T plus 2 is new to
10 the relationship. It's never been before a part of a trader
11 transfer. There's no evidence that in the contracts that it
12 wasn't business days, or it wasn't just calendar days. So I
13 think it's a real disputed fact what -- the T plus 2.

14 THE COURT: Well, it might be a disputed fact, but
15 the question is then, can I say that number one, if I don't
16 imply a gross negligence willful misconduct carve-out into
17 the force majeure clause, it doesn't matter. You say I
18 should, but it doesn't matter.

19 If I assume that there was gross negligence or
20 willful misconduct, which I don't, but if I do, then I could
21 still say as a matter of law, that the force majeure clause
22 applies nonetheless. Because of the --

23 MR. STEEL: So let's go -- I hear you, I hear you.

24 THE COURT: Okay.

25 MR. STEEL: So let's go to Section 29, force

1 majeure --

2 THE COURT: Okay.

3 MR. STEEL: -- clause. Let's get into the
4 substance of it. All right. So they say -- I still wanted
5 to make one more point on the timeline --

6 THE COURT: Sure.

7 MR. STEEL: -- it'll go really, really quick.

8 THE COURT: Go ahead.

9 MR. STEEL: That on Sunday, the 14th, it turned
10 the lights on here in New York and did tens of thousands of
11 transfers and transactions for favorite customers, why was
12 Newport out of that box? And then now we get to the fabled
13 15th, right? The plan administrator claims that the force
14 majeure now comes into play, because all of our claims are
15 allegedly caused, directly or indirectly, by quote,
16 government restrictions and suspension of trading. That's
17 the two --

18 THE COURT: Uh-huh.

19 MR. STEEL: -- clauses used in the force majeure
20 provision that's at issue.

21 All right. Our first argument that we're outside
22 of that is that the claims aren't based on government
23 restrictions or suspension of tradings. The claims are
24 based on Lehman's failure to recall and return the customer
25 property in advance of any of those waters getting onto our

1 toes, that's why the timeline is so important, that we
2 should've been (indiscernible), we should've been smooth
3 sailing outside of any insolvency proceeding or any
4 purported suspension of trading or government restrictions.

5 So that's our first argument why Section 29 is not
6 applicable. And just to add to that, Section 29 doesn't
7 even say insolvency proceedings. It says government
8 restrictions and suspension of trading.

9 THE COURT: Right. I went through that this
10 morning.

11 MR. STEEL: True. And let me get to our other
12 argument, other than the claim has nothing to do with
13 restrictions or suspensions, it's all about failure to
14 return and recall securities.

15 Your Honor, they spent a lot of time briefing this
16 issue, and they spent six and a half years, right, before we
17 got to litigate this on a 12(b)(6), six and a half years,
18 and now they're saying to a force majeure clause, well, I
19 don't see any evidence that there's a government restriction
20 or suspension of trading in play on the 15th. I got the
21 LBIE administration order --

22 THE COURT: You don't?

23 MR. STEEL: -- here, right here, right here, this
24 is the LBIE --

25 THE COURT: Right.

1 MR. STEEL: -- administration order.

2 THE COURT: Okay. And it said, LBIE's
3 administration business as usual?

4 MR. STEEL: It doesn't say that there's suspension
5 of trading or government restriction. It does not say it.
6 And under UK law, under UK law, as I understand there's
7 no --

8 THE COURT: Was LBIE still trading after it went
9 into --

10 MR. STEEL: Yes.

11 THE COURT: It was?

12 MR. STEEL: There was no automatic suspension of
13 trading. LBIE completed a substantial number of trades
14 post-administration. They cite in their papers. In fact,
15 one of the early progress reports from the administrators
16 was, in the context of OTC trades in limbo, they said, well,
17 suspension of trade is not practicable or desirable. It
18 would adversely affect the administration and recoveries of
19 beneficiaries, right.

20 Look how the trust claimants, how it evolves their
21 positions, people like Newport, the hedge funds stuck in the
22 morass. Prior to the UK high court rejecting a proposed
23 scheme for the return of their property, then they modeled
24 the CRA, which everybody fits under in this, well, what was
25 the administrators doing? They were entering into bilateral

1 negotiations with people like Newport on how to effectuate
2 these transfers.

3 THE COURT: That's what you mean by there was no
4 suspension of trading?

5 MR. STEEL: How -- if you're talking to me about
6 how to give me my property back, how is there suspension of
7 trading? I can get my property back from you, I don't read
8 that as a suspension of trading. And that's our other
9 position, that the UK administration order, UK law and the
10 actual events on the ground didn't effectuate a suspension
11 of trading. There might have been an insolvency proceeding,
12 there might have been an automatic stay saying I couldn't
13 bang on their door, but they sure as -- they could've
14 returned and recalled my securities.

15 And that's only the 15th, Your Honor, right.

16 THE COURT: Uh-huh.

17 MR. STEEL: We've got four more days until the
18 19th in the SIPA proceeding. So that -- then we're now
19 talking about how we're so far outside MF Global, right.

20 First Newport's not submitting a diminution in
21 value claim, this is in the SIPA claim. We're not like
22 Stonehill. And second, Lehman had nine days before the SIPA
23 order, and what that provided for came into play. And if
24 you look in the context of the nine days, or as Your Honor
25 says, seven days between the letter of authorization --

1 THE COURT: Uh-huh.

2 MR. STEEL: -- in my mind, that's gross negligence
3 for not being able to transfer many millions of a customer's
4 property at risk during Lehman -- this isn't a fire, this
5 isn't a riot, this wasn't an act of terrorism, it was --

6 THE COURT: But if it -- where do you allege that
7 you don't know where the securities were?

8 MR. STEEL: Well, I think we've alleged it in the
9 four or five 2004 applications we filed over the last six
10 years.

11 THE COURT: No, no, in the actual pleadings. Not
12 so much? I mean, in the proof of claim, because before -- a
13 half an hour ago, it wasn't on my radar screen at all that
14 what you really were saying was that the securities weren't
15 at LBIE they were actually at LBI.

16 MR. STEEL: Well, be mindful, this is our proof of
17 claim dated September 18th, 2009.

18 THE COURT: Yeah.

19 MR. STEEL: We say in the first paragraph on
20 information, believed the account remains with and under the
21 control of LBI and was not transferred to Barclay's Capital
22 or other third parties in connection with a mere sale.

23 THE COURT: Okay.

24 MR. STEEL: Remember, we filed a 2004 to answer
25 this question the first day.

1 THE COURT: Okay.

2 MR. STEEL: We went over to England to answer this
3 question, we've been asking it, Judge, we just haven't
4 gotten much clarity and it's very convenient for them to say
5 -- it's a no brainer, their securities were with LBHI. LBHI
6 filed for administration, there was a government
7 restriction, our hands were tied, force majeure kicks in.
8 Those aren't the facts that we understand them to be. And
9 this is a 12(b)(6) we should get the benefit of exploring
10 whether our facts are correct.

11 Your Honor, they still raise the other
12 exculpation.

13 THE COURT: Uh-huh.

14 MR. STEEL: We still have joint and several
15 liability, if you want us to address those too.

16 THE COURT: What do you mean, they --

17 MR. STEEL: If we get through the exculpation
18 gating, they're still saying that the debtors aren't liable
19 for these claims.

20 THE COURT: Right.

21 MR. STEEL: He said we sued a golf course, a
22 hotel, and a plane financing company.

23 THE COURT: Right.

24 MR. STEEL: And we have arguments with respect to
25 that if you want to hear it. Our papers go into pretty good

1 detail.

2 THE COURT: No, let me hear from Mr. Smith again
3 on this new --

4 MR. STEEL: Okay.

5 THE COURT: -- late breaking issue of where the
6 securities actually were. Thank you.

7 MR. STEEL: Thank you.

8 THE COURT: So, Mr. Smith, talk to me about LBI
9 and LBIE and talk to me about this notion that there wasn't
10 actually -- well, that if the securities were at LBIE there
11 wasn't really a suspension of trading that would've
12 precluded the return of the securities.

13 MR. SMITH: Okay. And different --

14 THE COURT: And if those are -- if I shouldn't
15 even be thinking about those issues, you can tell me that
16 too.

17 MR. SMITH: Right. Let's start with where are the
18 securities. The securities on Monday morning, as they were,
19 I believe on Friday and Thursday prior, were at LBIE.
20 There's no -- I can't imagine that there's a dispute about
21 that.

22 THE COURT: Okay. They're reacting --

23 MR. SMITH: They say that they --

24 THE COURT: -- with consternation to your
25 statement. So --

1 MR. SMITH: Okay. So they may not -- they may say
2 that they didn't know. That's fair, you didn't know.
3 That's -- you can take that position. But you certainly
4 knew when you were told Monday morning that they were on
5 lockdown at LBIE, that that's where they were.

6 And I'm assuming that that's lead that they got on
7 that Monday morning is what led them to go over to London,
8 meet with the administrator, and start the negotiation that
9 eventually ended up with an allowed claim that got paid.

10 So I think that's where you and I are confused
11 about what Mr. Steel is saying, is he's saying, I didn't
12 realize that they were at LBIE until that Monday morning
13 when the world turned upside down. Or is he saying, I don't
14 even know that they're still at LBIE, because that can't
15 possibly be true. He got paid by LBIE.

16 THE COURT: Well, there seems to be -- he seems to
17 be leading me to look beyond the world of T plus 2, and that
18 was a whole different set of arguments, that Monday is not
19 the operative day. A, Monday is not the operative day on
20 the -- at a sufficiency hearing because for all we know, the
21 securities might have been at LBI, and then that the wait
22 was longer, and they could've traded at that point.

23 So that seems to be one argument.

24 MR. SMITH: So the theory -- yes. The theory
25 would have to be they were really at LBI --

1 THE COURT: Right.

2 MR. SMITH: -- and LBI could've closed out that
3 Monday.

4 THE COURT: Exactly, yes, and it was grossly
5 negligent --

6 MR. SMITH: But they moved it to LBIE --

7 THE COURT: Oh, I don't think we get to the -- I
8 don't think I'm hearing that they moved it to LBIE, I think
9 it was just that it -- for all we know, it was at LBI, yes,
10 I have an allowed claim against LBIE, but that was a 9019,
11 that was a settlement driven by settlements between LBI and
12 LBIE, and the securities might have been at LBI, and if they
13 were, then it was grossly negligent to not close them out,
14 because oh, look, they can transfer securities within a
15 couple of hours.

16 MR. SMITH: Well, I'm puzzled that they would take
17 that position. It reminds me of the \$100 billion cash
18 hypothetical that you have, because it is so contrary to
19 fact they received and they've attached it as an exhibit,
20 Exhibit M to the May declaration is Mr. Rockmon e-mailing
21 back on the 15th to say, it's the very last exhibit in his
22 declaration, "I'm sorry to advise, all accounts under the
23 LBIE entity are under lockdown and we have lost access to
24 them," which is a simple statement of what the facts were.

25 "The administrators for the receivership is

1 PricewaterhouseCoopers and they will advise us in due course
2 on the road plan." Now, I can't imagine that they're truly
3 challenging that proposition and really what Mr. Rockmon was
4 doing was hiding that it was being held at LBI. So I don't
5 accept that as a creating an issue of fact.

6 THE COURT: So -- and if there were -- so then the
7 next level is that okay, let's assume they were at LBIE,
8 they were wrongfully hypothecated by LBI to LBIE, right?

9 MR. SMITH: Okay.

10 THE COURT: So you would say -- you're going to
11 say to me, well, that doesn't matter.

12 MR. SMITH: It's a) doesn't matter because the --
13 that's not their problem. Their problem was they put in the
14 order on Friday, and LBIE went into lockdown on Monday. So
15 it's too bad for them, they were just a little bit too late
16 in getting their paperwork together. So rehypothecation --

17 THE COURT: But if there was a wrongful --

18 MR. SMITH: -- it --

19 THE COURT: -- a so-called wrongful
20 rehypothecation then --

21 MR. SMITH: We don't -- I don't -- frankly I don't
22 know what they mean when they talk about a wrongful
23 hypothecation. But let's assume something was wrong.

24 All right. Let's assume they did something that
25 they didn't have the contractual authority to do.

1 THE COURT: Right.

2 MR. SMITH: Well then, what they did was breach
3 the prime brokerage agreement. And the breach of that
4 agreement is now precluded, a claim for breach unless there
5 was gross negligence, has been precluded by either one of --
6 either paragraph 30 or paragraph 29 of the prime brokerage
7 agreement. So they can talk all they want about they did
8 some weird thing with the rehypothecating and lifting
9 securities, a) I don't believe that there's anything wrong;
10 b) I don't know that that happened. It's because we don't
11 have visibility into what was going on at LBIE. And c) they
12 allege this on information and belief, and they have been
13 working with the LBIE administrator for the past six years
14 and never --

15 THE COURT: But you don't -- not to get into
16 disputed facts, but there's the margin lending agreement,
17 right? I mean, the fine line --

18 MR. SMITH: There is a margin lending, which
19 allows --

20 THE COURT: -- with your position is that it
21 completely allows the rehypothecation of the securities,
22 right?

23 MR. SMITH: Yes. And I suspect they'll say, well,
24 there are certain circumstances that you have to have a
25 loan-out or not a loan-out. We don't know any of these

1 things.

2 THE COURT: I'm just looking at the -- in the MLA.

3 MR. SMITH: It should be paragraph --

4 THE COURT: 5(e)?

5 MR. SMITH: That's an E or C.

6 THE COURT: Right.

7 MR. SMITH: Any collateral together with --

8 THE COURT: All right. So okay.

9 MR. SMITH: So -- but let's assume something was
10 wrong, that we didn't do something, we did something wrong
11 by whatever because of something that LBIE did. I'll make
12 it easy for you, you don't have to get to that issue,
13 because it is that kind of a claim is excluded by the gross
14 negligence limitation and liability.

15 If that was gross negligence to allow LBIE to do
16 something with the securities, it'd have to be gross
17 negligence in order for it to survive at the sufficiency
18 stage.

19 THE COURT: It would have to have been gross
20 negligence by LBI to have transferred the securities to
21 LBIE.

22 MR. SMITH: LBI to have transferred it, to put
23 them in harm's way with something.

24 THE COURT: Right.

25 MR. SMITH: And, of course, LBIE had been the

1 trading partner that these guys had used for years. So
2 there's nothing wrong in allowing securities to be held at
3 LBIE. That was actually what these fellows expected would
4 happen with those securities. So that answers the, I
5 believe, the rehypothecation and the location issues.

6 This -- I'm troubled by the notion that there are
7 these unliquidated claims that corporate -- they couldn't
8 vote securities or certain corporate events that they don't
9 describe, it's all --

10 THE COURT: Classic consequential damages.

11 MR. SMITH: Exactly. That's also in that same
12 paragraph, paragraph 30 precludes claims for consequential
13 damages. So those go out the door.

14 He says that there's a CapCo fraud claim. Well,
15 that's not what this claim is. The claim, as they've
16 attached it in their Exhibit A to their proof of claim, is a
17 breach of contract, you failed to capitalize CapCo or get a
18 surety bond.

19 So that is -- they don't ever use the word fraud
20 until well into these proceedings, when they have Mr. May
21 say that they were -- somehow it was fraudulent not to do
22 what they were supposed to do with the surety bond. But
23 that's -- Mr. Miller has already gone through that with you.
24 Those are the economic loss, you can't dress up a breach of
25 contract as a fraud.

1 So I hope I've answered your questions.

2 THE COURT: Yes, you have, thank you.

3 MR. SMITH: Okay. Thank you.

4 THE COURT: All right. Mr. Steel, quickly.

5 MR. STEEL: Yes. I'm sorry, Your Honor.

6 THE COURT: Don't be sorry.

7 MR. STEEL: Howard Steel on behalf of the Newport
8 Funds.

9 Oh, gosh, Your Honor, this is a 12(b)(6) and I
10 heard a lot from Mr. Smith we don't know, and that's a lot
11 of the problem, we tried to roll up our sleeves --

12 THE COURT: All right. But it's a 12(b)(6), but
13 it's also a Rule 11, okay. So you need to be standing up
14 here and looking me in the eye and telling me that, as you
15 stand here today, you're telling me gosh, gee, we don't know
16 where those securities were?

17 MR. STEEL: Yes, that's correct. Let me tell you
18 what I think happened from our limited dribs and drabs of
19 discovery from the SIPA trustee, you know, less discovery
20 from the joint administrators. We tried, we've cast our net
21 wide, we acknowledge that.

22 THE COURT: I just want to like flash some lights,
23 because this is a big moment. Okay. This is a big moment.
24 I'm not about cutting off claims prematurely or deciding
25 disputed issues of fact on sufficiency hearings or

1 12(b)(6)'s and I'm actually heartened by the fact that, in
2 fact, the objections to the sufficiency objection to the
3 guaranteed claim was withdrawn, because I think it has legs.

4 On the other hand, I believe notwithstanding the
5 language that you read me in the proof of claim, I don't
6 believe that you actually don't know where those securities
7 were. And if you're going to tell me that that's actually
8 what's going on here, you know, that's kind of a big thing.

9 MR. STEEL: Well, it's what I am telling you
10 because --

11 THE COURT: Pleading in the alternative is one
12 thing, lawyers do that all the time. But we're now many,
13 many years out and Mr. Smith has pointed me to documents
14 reflecting statements that indicated that, in fact, the
15 securities had -- were at LBIE, and has also said that you
16 acted on that in meeting with folks in the UK. He just said
17 that.

18 Okay. So if you're going to tell me that you're
19 resting your claim on the factual question of where were the
20 securities, and therefore, you want the ability to make out
21 a claim for gross negligence because the securities were
22 actually still at LBIE, is that really what you're saying?

23 MR. STEEL: What I'm saying is that there's no
24 evidence, there's no record, there's no documentation that
25 on the 15th the securities were stuck at LBIE. We have no

1 record that the securities were stuck at LBIE. I thought
2 Mr. Smith was just saying that we've dealt with the UK
3 entity in terms of relaying instructions, right, to purchase
4 or sell, right, that would make sense. We had a margin
5 lending relationship with LBIE.

6 THE COURT: Yes.

7 MR. STEEL: LBIE had certain rights, but just by
8 U.S. law, to rehypothecate, to lift the securities up from
9 what we thought they resided at LBI, the contract that we
10 signed, the prime brokerage agreement says, prime brokerage
11 agreement will be opened up at LBI, you identified that in
12 the Stonehill proceeding. That's what we understood. We
13 knew that LBIE had certain rights to lift and take those
14 securities --

15 THE COURT: Right.

16 MR. STEEL: -- within U.S. law and then do what --

17 THE COURT: And then on Monday, the 15th, after
18 Mr. May tries to get the securities back, a letter arrives
19 that says, gee, I'm so sorry, I can't give you your
20 securities back, because LBIE's in administration.

21 MR. STEEL: All right. Well, there's a couple of
22 points on this that still makes it really everybody in the
23 dark. This is coming from a New York person, Ramond is in
24 New York, there's no dispute on that.

25 THE COURT: Right.

1 MR. STEEL: So why is he -- why are we talking
2 with somebody from New York from just Lehman Brothers --

3 THE COURT: Because you asked for your securities
4 back, and that's who you dealt with, and the guy who's
5 telling you that he sent your securities to the UK is
6 responding with the --

7 MR. STEEL: But he didn't say that he sent the
8 securities anywhere. He just said -- the only thing he said
9 was they're on lockdown. I don't know what lockdown means.
10 And lockdown doesn't -- lockdown can mean many different
11 things.

12 THE COURT: Now, you've moved to a different
13 point. You've moved to the suspension of trading point.

14 MR. STEEL: All right. Well then getting back to
15 the where were the securities. We sought discovery for
16 that. Discovery was not given to us. What was given to us
17 was limited discovery of those things, was a document called
18 a sub-custody agreement.

19 It's a document -- it's in the record in these
20 proceedings, I can direct Your Honor --

21 THE COURT: No, that's okay.

22 MR. STEEL: -- although I think we got it in
23 discovery (indiscernible). And the sub-custody agreement if
24 I recall is an agreement between LBI and LBIE whereby LBIE
25 takes these rehypothecated securities and has them at LBI in

1 LBIE's name. That's why there was all these inner-debtor
2 conflicts with --

3 THE COURT: Right.

4 MR. STEEL: -- respect to where the securities
5 were, who had rights to the securities. That's why it
6 wasn't so easy for them to just transfer the securities back
7 to Newport.

8 So our point is we did not know with clarity where
9 the securities were. Some I think were rehypothecated in
10 the ether and they weren't -- Lehman was unable to recall --

11 THE COURT: Now, there's a new place they might
12 have been, LBI ether?

13 MR. STEEL: It was the two -- no.

14 THE COURT: Okay. Do you have any points that you
15 want to make to wrap up?

16 MR. STEEL: Your Honor, I think we've fleshed out,
17 of course, around the exculpation provisions. I think in
18 real brief, Section 30 for all the same reasons, because
19 there was no clear handling of these accounts for the
20 reasons that we said that it's unclear that anything was in
21 fact handled, we think that exculpation is not applicable.

22 And I think we can rely on Mr. Brilliant's
23 statements for the joint and several liability argument, in
24 addition to our proof of claim specifies the contractual
25 provisions where Lehman Brothers, the joint enterprise, were

1 responsible.

2 THE COURT: Okay. Any last licks, Mr. Smith?

3 MR. SMITH: No, I don't think so, Your Honor.

4 THE COURT: Okay. All right. Many, many
5 interesting points, but at the end of the day, I don't
6 believe it matters where the securities were, whether they
7 were at LBI or LBIE. I hesitate to give a lot of credence
8 to the allegation that there was some uncertainty, but it
9 ultimately doesn't matter.

10 I think that putting the guaranteed claim to one
11 side which was made clear to me it has been done, I think
12 these claims fall at the feet of paragraph 29 or paragraph
13 30 whether or not a gross negligence willful misconduct
14 exception is read into the -- what I've been calling the
15 force majeure paragraph, paragraph 29. And even if the
16 securities were still at LBI, I don't think it matters.

17 These claims don't survive a sufficiency hearing.
18 That being said, all the damages including the alleged
19 consequential damages can be sought in the further
20 proceedings in the guarantee action.

21 All right. So I would ask that you -- I mean, if
22 for the purposes of appeal, I mean, if you need a longer
23 opinion, I'd be happy to elaborate for the purposes of the
24 order, however, the basis of my ruling is that I believe
25 that this is on all fours with Judge Glenn's ruling in MF

1 Global, and I think it's equally applicable here. And I see
2 -- I've heard nothing that takes me out of that construct.

3 So for the purposes of -- let's talk procedure,
4 for the purposes of appeal, we can have an order, we can
5 agree that it's not final, we can wait to see what happens
6 at the end of the day. If it becomes something that needs
7 to go up on appeal we, of course, will write an opinion. It
8 has to go in the queue with everything else, so it's not
9 going to be accomplished very quickly.

10 I assume you'll agree on discovery. Do you need
11 me to do anything else?

12 MR. SMITH: No, I think we're done with that.
13 Thank you.

14 THE COURT: I'm waiting for this conference.

15 MR. STEEL: I'm sorry, Your Honor --

16 THE COURT: Is there something else, Mr. Steel?

17 MR. STEEL: -- Howard Steel from -- we just want
18 to acknowledge for the record we do need to preserve our
19 appellate rights.

20 THE COURT: Sure. So my question is, what do you
21 want to do? Do you want this to become a final order, I
22 don't -- if so, then I'm going to write an opinion. I'm
23 happy to do it, happy to do it, it's just not going to
24 happen really quickly. So what I was suggesting to you was,
25 we could have an order, have it not be final, and then when

1 you get to the end of the day -- I mean, if you win on your
2 guarantee claim, it rather renders moot the other claim.

3 I'm trying to preserve all of your rights, I'm not
4 trying to deprive you of any of your appellate rights.

5 MR. STEEL: Your Honor, Howard Steel again, can we
6 have till the end of the day for the determination, so I can
7 talk to --

8 THE COURT: Oh, sure. Just figure out whatever
9 works for you is fine with me. I just am trying to give you
10 a disposition in a way that moves it along, but I don't want
11 to eclipse any of your appellate rights whatsoever. But
12 take your time. All right?

13 Okay. I'm going to go take a break before the 2
14 o'clock hearing. Thank you very much. Good to see
15 everyone.

16 (Recessed at 1:48 p.m. and reconvened at 2:10 p.m.)

17 THE COURT: All right. Sorry to keep you waiting.
18 I'm ready when you are.

19 MR. COX: Your Honor, good afternoon, Stewart Cox
20 for the Defendant, Wellmont Health Systems.

21 Based on some of the arguments I heard earlier and
22 the Court's questions, I'm guessing this is going to be an
23 easy one for Your Honor to tackle.

24 THE COURT: Yes, actually.

25 MR. COX: And hopefully it won't take quite as

1 long. We have -- Wellmont has before the Court a motion to
2 dismiss.

3 THE COURT: Right.

4 MR. COX: A motion to dismiss three of the four
5 claims, counts in the Lehman adversary complaint and as the
6 Court may know, Lehman on Friday dismissed the two
7 Bankruptcy Code claims.

8 THE COURT: Right.

9 MR. COX: So we have one claim --

10 THE COURT: Counts I and IV.

11 MR. COX: Correct.

12 THE COURT: Right.

13 MR. COX: One claim left that's the subject of the
14 motion to dismiss, and that's the breach of the implied
15 covenant of good faith and fair dealing claim.

16 And the primary point that I want to offer the
17 Court today in this argument is that the implied covenant
18 claim and the breach of contract claim that's Count I that
19 we're not addressing the motion, and even the two bankruptcy
20 claims that were dismissed, the entire case rests on certain
21 language on a document that we call the certifications.

22 And that language is quoted, as the Court knows in
23 the complaint --

24 THE COURT: Right.

25 MR. COX: -- and all four counts, and now we're

1 talking about Count IV. That's the entire predicate for the
2 implied covenant claim. And as Your Honor knows from our
3 motion, our argument is, our legal argument is the implied
4 covenant claim is redundant. It duplicates the breach of
5 contract, the express contract claim that they have in Count
6 I.

7 So that's our argument. And if the Court will
8 indulge me, I'll back up a little to explain the background
9 with the contract, and then I'll come back to the
10 certifications that's the documents of the subject of their
11 adversary proceeding complaint.

12 THE COURT: So the -- you dispute that the
13 certifications are contract, right?

14 MR. COX: Correct.

15 THE COURT: Okay. So if the certifications can't
16 support, if the certifications are a contract then do you
17 lose or do you say I think the certifications are not a
18 contract, but even if you hold that -- find that they are,
19 we didn't breach anything?

20 MR. COX: Correct on both counts.

21 THE COURT: Okay. But then, but then you get to
22 the issue of the breach of the implied covenant and good
23 faith and fair dealing which is implied in every contract
24 governed by New York law. So even if there is no breach of
25 an express provision of a contract, there can be a breach of

1 the implied covenant with good faith and fair dealing,
2 that's read into the contract.

3 So I'm trying to figure out whether this is a, you
4 know, a semantic difference, if you will, because I believe
5 that there is a cause of action for the breach of a covenant
6 and good faith and fair dealing that can prevail subject,
7 you know, based on factual record, even if there's no breach
8 of another express provision of a contract. Okay?

9 MR. COX: Yes.

10 THE COURT: Go ahead.

11 MR. COX: Let me respond this way, if the
12 complaint had only an implied covenant count, or implied
13 covenant count plus the two bankruptcy counts that were
14 dismissed, we wouldn't be attacking that implied covenant
15 count with a motion to dismiss, because we're not saying
16 they don't have a cause of action. What we're saying is,
17 they can't both coexist.

18 THE COURT: But what if their complaint said
19 complaint, complaint in one count? Okay. Breach of
20 contract, recitals, recitals, recitals, paragraphs,
21 paragraphs, and then there's a paragraph that says, they're
22 liable because they breached the express provision set forth
23 in paragraph XXYY, they breached the implied covenant of
24 good faith and fair dealing, wherefore, we get -- we win.
25 One count just two different contractual provisions; one

1 express, one implied.

2 MR. COX: Because the way they have the complaint
3 pled is not -- there's no implied term that's even pled in
4 the complaint. The complaint rests entirely on the language
5 in that certifications document that they have quoted --

6 THE COURT: Uh-huh.

7 MR. COX: -- in the complaint. That's why they're
8 redundant. And that's why these New York cases that we've
9 cited to the Court say, you can't have both. And to pick up
10 on the Court's about it being semantics, why would it matter
11 if they're pleading the same thing in one count, versus
12 pleading the same thing in two separate counts? Because at
13 the end of the day, the Court's going to look at what
14 they're really alleging to support the breach of contract
15 theory, whether it's on an express term or implied term, and
16 the Court is going to see this is based on specific language
17 that's in that certifications document.

18 THE COURT: But it's based on specific language,
19 but even if I were ultimately to conclude that there was no
20 breach of the specific language, but that the course of
21 conduct constituted a breach of the covenant of good -- of
22 the implied covenant of good faith and fair dealing, I could
23 still find in Lehman's favor.

24 MR. COX: I can't argue against that, Judge. But
25 we could hypothesize about different ways. They could plead

1 the complaint.

2 THE COURT: Right.

3 MR. COX: And that's not what we have today, what
4 we're facing. What we're facing right now is a complaint
5 that has two different counts that duplicate each other.

6 THE COURT: But you're telling me that they can't
7 plead both, right?

8 MR. COX: Correct.

9 THE COURT: And I'm telling you that they actually
10 can plead both. So I hope -- have you read what I've
11 written about the breach of the covenant of good faith and
12 fair dealing?

13 MR. COX: I don't know that I have, Your Honor.

14 THE COURT: All right. Well, some young person
15 who works for you didn't do their job. Because if you look,
16 you'd see it, I had a decision on the issue of the breach of
17 covenant of good faith and fair dealing.

18 MR. COX: Is it in this Lehman case?

19 THE COURT: No, it's not in the Lehman case, it's
20 another case called Lightsquare.

21 MR. COX: All right.

22 THE COURT: It doesn't matter, though, because
23 it's a contract claim. So, you know, I don't want to --
24 I'll let you continue to try to convince me --

25 MR. COX: No, I --

1 THE COURT: -- but I'm just kind of letting you
2 know --

3 MR. COX: Okay.

4 THE COURT: -- that it's going to be an uphill
5 battle. Thanks.

6 MR. COX: Thank you, Judge.

7 THE COURT: So but if you would rather that the
8 counts be combined so that we have a breach of contract
9 claim and that as life moves on, they either have to prove a
10 breach of an express provision, or demonstrate the breach of
11 the implied covenant of good faith and fair dealing all
12 under the rubric of a contract claim, that's -- we can do
13 that. I mean, I don't think that it really matters. We're
14 going to go to trial, apparently not here, unless you
15 consent, which I'm guessing after today you won't. I'd be
16 delighted to have you, but you know, we still -- it's still
17 going to be the same record however you sort it out, right?

18 MR. COX: Right. We do think there is a
19 substantive difference between what Your Honor has
20 articulated and how it ought to be pled and the way it's
21 pled today. So understanding how the Court is inclined to
22 rule on this, we do feel like it's at least incumbent on
23 Lehman to amend the complaint to set forth a breach of
24 contract claim as the Court has articulated it in one count.

25 THE COURT: Let me hear from Lehman, Mr. Cohen.

1 You know, from my perspective, I don't think it really
2 matters, but you may have a different view. I'm trying to
3 preserve the cause of action because I think that Lehman's
4 entitled to go forward and attempt to prove one or the other
5 or frankly both, because they're I think in this
6 constellation of alleged facts, there is room for both. But
7 what do you think, Mr. Cohen?

8 MR. COHEN: Good afternoon, Your Honor, David
9 Cohen, Milbank Tweed Hadley and McCoy on behalf of Lehman
10 Brothers Holdings, Inc. and Lehman Brothers Special
11 Financing, Inc.

12 I think the issue with redundancy and the cases
13 that deal with that are concerned with the potential for
14 double recovery on a single theory.

15 THE COURT: Yeah.

16 MR. COHEN: And that's absolutely not --

17 THE COURT: Not on the table at all.

18 MR. COHEN: We're not at all.

19 THE COURT: Right.

20 MR. COHEN: And if Wellmont conceded that the
21 certifications were part of the contract, then we wouldn't
22 need the implied covenant. But as we sit here today, there
23 is a question as to what's covered by the contract --

24 THE COURT: Right.

25 MR. COHEN: -- and what isn't. And that's why we

1 pled in the alternative.

2 And in the motion to dismiss papers, they seem to
3 suggest that we missed some special language by saying in
4 the alternative, we'd pled breach of good -- covenant of
5 good faith and fair dealing. We've looked at the Rule 8
6 cases, we don't think we have to. We think it's fairly
7 clear we understand, and we've understood from the beginning
8 that at least as we view the case and the facts, once the
9 Court determines whether the certifications are part of the
10 contract or out of the contract, the nature of the case
11 changes.

12 And we're either going with breach of contract on
13 the certifications as part of the contract, or we're going
14 with the certifications as part of the expectations and the
15 reasonable expectations of the party at contract formation,
16 and they're --

17 THE COURT: Down the implied covenant path.

18 MR. COHEN: Exactly.

19 THE COURT: Right.

20 MR. COHEN: And they're post contract conduct to
21 frustrate the performance.

22 THE COURT: Well, that's the way I see it. So
23 there's no chance of double recovery, and I didn't
24 understand Lehman to be seeking a double recovery.

25 MR. COHEN: Absolutely not.

1 THE COURT: It's just kind of classic alternative
2 pleading and the cases that say you can't do both, I think
3 are just, you know, they're just a little misleading.
4 Because I think in this -- you know, this is -- would be a
5 classic example of a case in which you need to be able to
6 pursue both. I mean, the undisputed facts that we have,
7 i.e., you know, the redemptions, you know --

8 MR. COHEN: Right.

9 THE COURT: -- I mean, it's frankly a very
10 fascinating set of facts and legal issues. But I don't
11 think that, Mr. Cox, that I want to put the debtors through
12 the additional expense of, you know, trying it again and
13 risking that we haven't said in some -- that they haven't
14 pleaded in some magic way that parties could differ about.

15 They have a cause of action I think that survives
16 a 12(b)(6) for express, for implied. And then at the end of
17 the day, they'll either prevail on one, or they'll prevail
18 on the other, but not both.

19 So I'm inclined to just deny the motion with
20 respect to Count IV, leave it the way it is, and you know,
21 let's move on.

22 MR. COHEN: That would be fine with us, Your
23 Honor.

24 THE COURT: And I'm delighted that you came up to
25 enjoy our -- you brought us the sunshine actually.

1 MR. COX: You have a beautiful --

2 THE COURT: So for that, we're thankful, but you
3 better get out quickly because the temperature is going to
4 be dropping.

5 MR. COX: No further argument on that, Judge.

6 THE COURT: Okay.

7 MR. COX: I did want to ask the Court one more
8 question here, and Your Honor may not have had a chance to
9 see it yet. We submitted a --

10 THE COURT: I did. A confidentiality --

11 MR. COX: Exactly.

12 THE COURT: -- a protective order.

13 MR. COX: Right. And the only reason I bring it
14 up now is we have a deposition coming up on February 25
15 where we probably will use documents that are --

16 THE COURT: Okay. So I will enter this. I'm
17 going to go in the stack and this will get entered by the
18 end of the day. Today, Mr. Cohen, you had no issues with
19 this?

20 MR. COHEN: No, we commented on earlier drafts,
21 the defendants accepted our comments, and --

22 THE COURT: Okay.

23 MR. COHEN: -- the version reflects those.

24 THE COURT: Okay. We need an electronic copy.

25 UNIDENTIFIED: E-mail my (indiscernible).

1 MR. COX: Fine.

2 THE COURT: All right. So if you can't do that
3 today because you're in transit, then we'll enter it as soon
4 as we get it. But surely we'll enter it by the time of your
5 deposition.

6 Can I clarify something, because this is back to
7 me after denial of a motion to withdraw the reference,
8 right? So I am going to take this through trial or not. I
9 know that it's clear that I don't have authority to enter a
10 final order, right or not right? But -- well, that's what
11 the district court said.

12 MR. COX: Well, as the Court knows better than me,
13 this is of course is a jurisdictional thicket, but I don't
14 understand the need for us to play ping pong with the
15 district court --

16 THE COURT: Your words not mine.

17 MR. COX: All right. Well, I do have to be
18 careful because she still has her thumb on us, but I don't
19 see the need to submit a report or recommendation to the
20 district court just on a motion to dismiss. As the --

21 THE COURT: Okay. I wasn't -- I agree with you on
22 that, and the motion to dismiss, no. I'm beyond that. I'm
23 at the after trial or summary judgment.

24 MR. COX: Okay. I'll just say, Wellmont is not to
25 that point yet, Judge.

1 THE COURT: Okay.

2 MR. COX: We've got a lot of discovery to do and
3 then we probably will file a summary judgment motion in this
4 court, and it's probably too early for us to --

5 THE COURT: That's fine. That's fine. I just
6 want to note what the district court said in the order
7 denying the motion to withdraw the referencing and come
8 back, so let's all just remember to revisit it, revisit that
9 issue as and when it becomes relevant, but it doesn't really
10 affect what we do.

11 MR. COHEN: We will, Your Honor.

12 THE COURT: Okay. All right. So you'll send us
13 the protective order by e-mail, and will you send us an
14 order on Count IV as well?

15 MR. COHEN: Yes, we'll prepare that and send that
16 back to you and Ms. Stewart (ph) will get your comments on
17 that.

18 THE COURT: Okay. All right. Thank you so much.

19 MR. COHEN: Thank you, Your Honor.

20 THE COURT: Good day.

21 (Proceedings concluded at 2:26 PM)

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C E R T I F I C A T I O N

I, Dawn South, certify that the foregoing transcript is a
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